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STRENGTHENING SOCIAL SECURITY TO MEET THE NEEDS OF TOMORROW'S RETIREES

HEARING

BEFORE THE

SUBCOMMITTEE ON SOCIAL SECURITY, PENSIONS, AND FAMILY POLICY

OF THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ONE HUNDRED THIRTEENTH CONGRESS

SECOND SESSION

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STRENGTHENING SOCIAL SECURITY TO MEET THE NEEDS OF TOMORROW'S RETIREES

WEDNESDAY, MAY 21, 2014

U.S. SENATE,
SUBCOMMITTEE ON SOCIAL SECURITY,
PENSIONS, AND FAMILY POLICY,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 10:02 a.m., in room SD–215, Dirksen Senate Office Building, Hon. Sherrod Brown (chairman of the subcommittee) presiding.

Present: Senators Nelson, Isakson, and Toomey.

Also present: Democratic Staff: Michael Evans, General Counsel; Tom Klouda, Senior Domestic Policy Advisor; and Kara Getz, Senior Tax Counsel. Republican Staff: Jeff Wrase, Chief Economist; and Preston Rutledge, Tax Counsel.

OPENING STATEMENT OF HON. SHERROD BROWN, A U.S. SENATOR FROM OHIO, CHAIRMAN, SUBCOMMITTEE ON SOCIAL SECURITY, PENSIONS, AND FAMILY POLICY, COMMITTEE ON FINANCE

Senator BROWN. The subcommittee will come to order. Thank you, Senator Toomey, for joining us—Senator Isakson. I know others will be here.

Thank you very much for this very distinguished panel. All four of you have contributed a great deal to this public debate, and I look forward to expanding on all of these issues in questions and answers.

I want to start by reading a letter. This letter is from my Assistant State Director back in Cleveland; she grew up in Pennsylvania. Her grandfather worked for Pennsylvania Gas and Electric, and her father came across this letter in his stack of papers. Her father is in his 80s. This was a letter to her grandfather from the Pennsylvania Gas and Electric Company, and I want to just share this letter.

It is dated December 24, 1936, and it is signed by the vice president of this company in Senator Toomey's State. It says, "Dear Fellow Employee: On August 14, 1935, Congress passed the Social Security Act. Under provision of this Act, the company is required to deduct 1 percent of your wage beginning this January, 1½ percent beginning January 1940, 2 percent January 1943, 2½ percent January 1946, and 3 percent January 1949. These deductions, matched by your company, are designed to provide for your retirement at age 65." The letter goes on.

But think about that. You are a worker, getting by, not making a huge wage but doing all right, and you have this whole Social Security thing—it was an untested idea. You may not have even heard of it; if you had, you did not know much about it. Your employer says they are taking progressively up to 3 percent of your wage.

The employer is going to match it, and then you are going to get it sometime later when you are 65. And you look around at your family and you realize, nobody in my family has even lived to 65. And it makes you understand how difficult it is to launch any of these major social insurance programs, whether it is Social Security or Medicare or even now the Affordable Care Act.

Today, obviously, we all know Social Security. It is woven into the fabric of our country. A few years ago the idea that we would expand Social Security seemed so unlikely; all the conventional wisdom in this town was that we would have to cut Social Security.

Today, not only are cuts to Social Security deeply unpopular, but we are debating how much we need to expand the program. Today's hearing is to consider whether Social Security is adequate to meet the challenges facing today's workers and to discuss what policies we should consider to expand the program.

Over the last few years, we have fallen into the bad habit of allowing the debate around Social Security to be conducted in the context of the budget. This is not serving seniors; this is not serving our country.

First, discussing Social Security in the context of the Federal budget misleads the public. Social Security has its own dedicated source of funding.

Second, most importantly, we should not be raising Social Security in the context of the Federal budget; instead, Social Security is about retirement security, about family budgets. Social Security is social insurance. Let me repeat that: Social Security is social insurance.

It is a plan that offers working families a modest bundle of insurance products—retirement, life, disability insurance—at reasonable rates. For the bottom two quintiles of Americans over 65, Social Security benefits represent 84 percent of their retirement income. For the middle quintile of the five, households with an $18,000 maximum benefit, Social Security benefits represent some 65 percent of retirement income. Even in the fourth quintile, Social Security benefits represent 44 percent of a senior's retirement income.

Social Security is one of the three legs of the retirement stool we talk about. The other two legs of the stool—personal savings and pension plans—have, for many, many, many workers in this country, virtually been sawed off. Wages have stagnated. Folks are struggling to make ends meet, let alone put aside money for retirement. Defined pension benefits we know have declined. Only half of workers have access to an employer-sponsored retirement plan, making Social Security more important than ever. It lifts 22 million people out of poverty. In Ohio, there are 2 million Social Security beneficiaries. The program keeps more than 600,000 seniors out of poverty.

I met a Youngstown woman at a town hall a couple of years ago. She said she worked two jobs; she was struggling, she was not

making much money. She said, "I am 63 years old. I just need to stay alive another year and a half so I can have health insurance." And that is what she was focused on—"I have just got to get to Medicare age." So we know how important these two social insurance programs are.

To me, it is a moral issue and an economic issue. Last year, Social Security benefits fueled $1.4 trillion in economic output. They supported 9 million jobs and generated $200 billion in payroll tax revenue. And keep in mind that Social Security's benefits are modest. Most checks are not much more than $300 a week.

At the same time, the program is highly efficient. Less than 1 percent of revenue is used for administration. We know that bipartisan legislation in the Reagan years, in 1983, and then the Clinton years, in 1993, placed the program's finances on a predictable path.

This tradition of common-sense, bipartisan actions should continue as we reallocate the Disability Trust Fund, a simple process that Congress has done bipartisanly 11 times since 1957. Reallocation is not controversial. Twenty years ago, the Social Security Trustees predicted we would need to reallocate the Trust Fund in 2016. They were right; we will.

Simple reallocation can be done without increasing taxes or decreasing benefits and will result in the program being solvent for the next 2 decades. We know the financing options that will make it solvent for decades to come and fund the kinds of expansions we know are necessary to confront the retirement crisis.

We have to have the courage to act. Social Security is under duress today, despite its inherent strength. Current laws baked a series of cuts into Social Security that will slowly erode retirement benefits by 25 percent over the next few decades. But raising the retirement age, increasing taxes, delaying cost-of-living adjustments, or COLAs, are blunt instruments that only harm low-income workers.

Americans who work construction, Americans who work in diners, Americans who work in steel mills, cannot work until they are 70; they cannot retire with dignity without the savings to do so. Americans who have worked hard all their lives are seeing prescription bills increase. They cannot afford a tax increase or an unreasonable cost-of-living adjustment.

That is why we should consider proposals to expand Social Security, including a bill Chairman Harkin and I have introduced to change the benefit formula, particularly for low-income workers, and to update the cost-of-living adjustment to reflect the true cost of living for seniors.

We will discuss proposals to increase survivors' benefits. We know that, for so many low-income families, it is the only life insurance available. We will discuss proposals to increase the benefits for the most vulnerable people. We can do this by updating the SSI program, which has not been updated or indexed in literally 40 years.

We will examine proposals to provide caregiver tax credits to workers who support children or parents. When children leave the workforce to care for their aging parents, that is real work. Those caregivers deserve a modest but dignified retirement.

Finally, we will talk about ways to use Social Security's proven track record to help working families by expanding the program to provide paid family leave and help the children of deceased beneficiaries attend college.

[The prepared statement of Senator Brown appears in the appendix].

Senator BROWN. I will stop there and yield to my fellow, if I can say Eagle Scout, Ranking Member Toomey.

OPENING STATEMENT OF HON. PATRICK J. TOOMEY, A U.S. SENATOR FROM PENNSYLVANIA

Senator TOOMEY. Thank you, Mr. Chairman, and thanks for calling this hearing. It is an extremely important topic.

And I completely agree with the part of your analysis about the importance of the program, which is exactly why we have to take the measures necessary to ensure that Social Security will actually be there for future generations, so that it can play the vital role for them that it has played in recent decades and past decades.

But part of that means acknowledging some of the fundamental problems. Number one, the program is insolvent. The present value of the promised benefits is much greater than the present value of the revenue that is meant to pay those benefits. And that is not a problem with some distant future implications. It is running a cash-flow deficit now. It has been since 2010—over $200 billion in deficits the last 4 years and $75 billion per year, on average, going forward. This is the amount by which payroll tax revenue, which is meant to fund the program, is less than outgoing benefits.

Structural reform is necessary, and the sooner we do it, the better. Unfortunately, if we cannot agree that there is a problem, it is hard to make progress on the solution. The observation that this is a problem, by the way, is not a partisan matter. I think it is a matter of arithmetic.

I want to quote briefly from the Social Security Trustees 2013 Report. So this is the Social Security program describing itself; it says that, quote, "Both the Social Security and Medicare programs face substantial financing shortfalls that require legislative corrections. It is important to grasp that the amount of time remaining to enact a financial solution is far less than the amount of time projected before final depletion of Social Security's combined trust funds. If lawmakers take action sooner rather than later, more options and more time will be available to phase in changes so that the public has adequate time to prepare. Earlier action will also help elected officials minimize adverse impacts on vulnerable populations, including lower-income workers and people already dependent on program benefits."

As the Social Security actuaries have noted, the fundamental problem is that spending in the program is increasing faster than the economy is growing. That is pretty much the definition of unsustainable. Over the next 10 years, the forecast is for nominal GDP to grow at 4.5 percent per annum, while Social Security will grow at 6.1 percent per annum.

Tax increases are not the answer. Tax increases will not bring the spending growth in line with GDP growth, and will be economically destructive. Since President Obama has taken office, we have

seen $1.8 trillion in tax hikes over a 10-year period, and economic growth is anemic—only one-tenth of 1 percent last quarter, and we have the lowest labor force participation rate in 35 years. These are not coincidences.

I should also point out that the math does not work very well. Even, for instance, if you completely eliminated the current existing $117,000 cap on the maximum earnings that are subject to the payroll tax, it would amount to a massive tax increase, and the program would return to a deficit position in 11 years.

The solution is that we have to change the rate of growth and bring it into line with GDP growth. No government program can grow faster than the economy indefinitely, so we have to make the decisions. And the sooner we do it, the better it will be for the people who depend on this essential program.

So thanks again, Mr. Chairman. I look forward to the testimony of our witnesses.

Senator BROWN. Thank you, Senator.

[The prepared statement of Senator Toomey appears in the appendix].

Senator BROWN. Senator Isakson?

OPENING STATEMENT OF HON. JOHNNY ISAKSON, A U.S. SENATOR FROM GEORGIA

Senator ISAKSON. Well, thank you, Chairman Brown. I will be brief, but thank you for the time.

I think there are two issues. I will tell a brief story. I was born in 1944. In 1983, Tip O'Neill and President Reagan got together with leaders of Congress, and they said, "We have a problem. Social Security is not working. It is going negative. We have to fix it." And so they passed a law. No one lost at the polls in 1984 on this, by the way, not a single member of Congress.

They passed a law and said that anybody born after 1943 is no longer eligible for Social Security at age 65. They have to wait till age 66. I was born in 1944, so I was the first of a group of Americans who were told, "We are taking away 1 year of your benefit."

I was 39 years old. I did not think I was going to live to be 65, first of all. My father had always told me the government was going to screw it up anyway, so I did not really pay a whole lot of attention to it. Now I am 69 years old, and I realize I lost one of my years of Social Security. But I did not really miss it, because there was a long-range change in the fundamentals of the formula, but it was a change in the out-years. I never considered it a cut in benefits. I considered it a saving of the program.

So it is only right for us to look at what Reagan and O'Neill did as a template for what we need to do. And we need to adjust the eligibility and the formula to fit the 21st century for my grandchildren and my children.

There is a second thing we need to do. We need to take some of the pressure off the Social Security system by empowering retirees and people who will retire to save and invest more for their future. Now I understand, for the very lowest income earners, that sounds good, but it is just not possible, because they have to live within their means, and they do not have the money left over. But for

most Americans, a vast majority, they are not saving for their retirement. They are not planning for their retirement.

So it is important for us to take the tax incentives that we have in the code for IRAs and 401(k)s and Roths and empower people to save. Every time somebody has saved for their retirement, it takes pressure off the Social Security system for additional benefits.

So, as we talk today about saving Social Security, part of that is the responsibility of the retiree to help save for themselves. Social Security may have been intended as that letter you read from 1935 portended. It may have been intended to be your retirement program, but we all know we cannot afford a program that would be a retirement program in the 21st century.

It is a social insurance contract; it is not an entitlement. People have paid premiums for it; they deserve a benefit. But they deserve for us to make sure we are protecting that benefit in the out-years.

So I welcome the opportunity to hear from our experts, and I welcome the opportunity to talk not only about saving Social Security, but about empowering retirees to save for themselves.

Senator BROWN. Thank you, Senator Isakson, for your always-wise comments.

The first witness is Stephen Goss. Mr. Goss is Chief Actuary, Social Security Administration. He has been Chief Actuary since 2001. He has devoted his career to public service. He joined the Office in 1973 after graduating from UVA with a master's in mathematics. The Office of the Actuary is the scorekeeper for policy affecting the Social Security Administration. Mr. Goss and his team provide us with invaluable nonpartisan resources and insight. We appreciate his work.

Next we have Dr. Teresa Ghilarducci. She is the chair of the economics department for The New School for Social Research in New York. Dr. Ghilarducci has been working on retirement security issues literally her entire working life. As a 21-year-old, we found out, she consulted with unionized workers at Stanford about their benefits and helped them choose pension plans. She is one of the Nation's foremost experts on retirement security. We appreciate her joining us.

Next we have Jason Fichtner. Dr. Fichtner is a senior research fellow at George Mason. He was a former Deputy Commissioner in the Social Security Administration and served as the Social Security Administration's Chief Economist. He also will soon marry a former intern of mine, when I was in the House of Representatives. Congratulations on that—not that she was an intern of mine, but on the marriage. [Laughter.]

Finally, we have Dr. Maya Rockeymoore, president and CEO of the Center for Global Policy Solutions. Dr. Rockeymoore is a Capitol Hill alum, where she staffed the Ways and Means Committee and was Chief of Staff to one of my favorite House members when I was over there, Congressman Rangel. She is a lead author of a plan to strengthen Social Security for communities of color and other vulnerable groups. Thank you for joining us.

We will begin with Mr. Goss. Thank you.

STATEMENT OF STEPHEN C. GOSS, CHIEF ACTUARY, SOCIAL SECURITY ADMINISTRATION, BALTIMORE, MD

Mr. GOSS. Chairman Brown, Ranking Member Toomey, and Senator Isakson, thank you very much for the opportunity to come and talk to you about this really important topic today. Actually, I think, among the three of you, you pretty much covered everything, so let me try to fill in a couple of details here.

There are really three things that I would like to just very briefly mention to you today in these brief moments. One is really the global challenge of aging. It is not just the U.S.; it is everywhere, especially the OECD nations. The second item is Social Security benefit levels and the adequacy of those benefits. And third is a little bit about the options, of which there are so many, and we simply will not have time in this brief testimony to really get into that.

The slide that we have here, I have a little graph of something that is referred to as the "aged dependency ratio." Most are familiar with this. This is just the ratio of the number of people 65 and older to the number of people who are of working age, 20 to 64. And this ratio, this line, if you look at it, the top line is what we are actually facing, going forward in our Nation. As Senator Toomey well pointed out, we are going to have a big increase in the number of people who are over 65 relative to those who are under 65 in our adult population. And we can just see how that is going.

Now, what is really important in thinking about that is why, exactly, is that happening? People usually think, well, obviously, it is because everybody is living longer. Death rates are dropping like crazy. Actually, that is really not the case. If you look at the center and the bottom lines, these two lines indicate what would be happening to this ratio of folks over 65 to folks of the working-age population if the birth rate that we had had prior to the end of the baby boom generation had stayed at either 3 children per woman or 3.3 children per woman. You can see that this aged dependency ratio, if it just continued growing at a very gradual and slow rate, as it has in the past, would not really be a big deal. The big jump we have is for another reason; it is because the birth rate dropped.

Now, this is not to suggest for a moment that we should have kept the birth rate where it was. I am old enough to remember the mention of somebody named Malthus, way back when we were worried about the overpopulation of the world. But the bottom line is, this is the challenge we are facing. We are facing a level shift in the ratio of aged folks to working-age folks, because of the drop in the birth rate. And I am just suggesting we should keep that in mind when we talk about how we address this challenge.

By the way, be glad we are not Japan, because they have a much bigger problem, and South Korea. Their birth rates are down at 1.2 children per woman. Ours are still at two children per woman.

So on the next slide, we have an indication of what really this means, what it is doing for Social Security. As we all well understand, and as the Trustees have pointed out, over the next 20 years we will have a rise in the cost of Social Security as a percentage of gross domestic product that is not only predictable, but it is all but certain. The people who will be involved in generating this increase in cost over the next 20 years are already born. And this follows directly from that change in the number of people 65 and

older compared to those of working age, because after all, benefits for Social Security are largely the result of people 65 and older, and the GDP and taxable payroll for the program are generated largely by people age 20 to 64.

So it is no surprise at all that we have this level shift, and that is really a key point. It is a level shift up to a higher level. Social Security had been about 4.3 percent of GDP for decades. It is going to rise up over the next 20 years to about 6 percent of GDP and stabilize, under all reasonable projections that we could possibly make.

On the next slide, we just have a little indication of really what the level of Social Security benefits is. I think, as Senator Brown mentioned, the level of Social Security benefits, $300 a week, that is about $1,270 per month in 2013. And that is actually about 35 percent of what the average amount of covered earnings is for workers in this country.

If you peel that back a little bit and consider not just the average covered earnings, but leave out the earnings for those who earn over $117,000, we end up with a little bit lower average taxable earnings, and our average benefit is about 42 percent of that.

So it is probably not, by any measure, sufficient to cover all of people's retirements needs, but it is a good foundation. It is a good floor of protection. It is a good, solid one leg of the stool, and we wish we had more of the others.

And the one comment that I would want to make on that is that the issue with the other legs of the stool is not that they have disappeared for everybody. They have certainly diminished. But one of the key points really is annuitization. What Social Security offers in its benefits is a life annuity. A lot of people are talking now about longevity insurance, longevity protection. A life annuity takes care of that for you. A lump-sum amount of money when you reach retirement that you then manage yourself does not give you assurance of having a lifetime income for the rest of your life. And more and more, our employer-provided pensions and savings that people have put together on their own are not going into annuities. So Social Security is the only thing that people have assurance of.

Senator Isakson, we hope that you will make it way past 69, and when you get up to age 89, if you do not have life annuities, you could well be running out of resources, and many American citizens will be in that position.

On the next slide, we have an indication of something that we actually have in the Trustees Report, which are benefit replacement rates. And you can see how these went up, and they reached a peak around 1980 and have been brought back. This is at age 65, and benefit replacement rates are just the amount of money that people receive as a benefit in the first year of benefits compared to some measure of what their earnings level was in their career.

In this case, because people's earnings levels in our country do not follow any particular pattern, we look at what the average earnings level is on a wage index basis over their entire career. That also is the basis upon which we determine the benefit levels under Social Security currently. And we can see that this ranges anywhere from maybe 30 percent of the benefits that people receive, 25 to 30 percent for our highest earners, down to our lowest

earners getting about 50 percent of a replacement rate. And, as mentioned on the earlier slide, it is about 40 percent on average.

But we do have another way of looking at this, which we looked at much more carefully recently, on the next slide with this bar chart. And, if you look at what we call the median level—that is the place where half the people have higher replacement rates, half have lower replacement rates—what we typically looked at is on the black bar.

And you can see where we have a dark gray bar, which is what we show in the Trustees Report, these are, for hypothetical workers, our benefit replacement rates—that is, benefits that you get in your first year of benefits, relative to what your earnings level has been. At the median level, we are at about 40 percent, and we are about 40 percent on this long career average.

We are also at about 40 percent on another measure of earnings, which is not just the long career average, but if we look at the last 5 years of pretty solid, non-zero earnings. What we actually did here is something new we have developed really for this hearing. We looked at the last 5 years in which you actually had earnings and we ignored the most recent one, because that is probably the year of your last earnings. And on average, people worked only half a year in that year. So we left that one out and looked at the five preceding that, took the average of that, wage-indexed that, and, lo and behold, it turns out to give a very, very similar result on replacement rates to what we have in the Trustees Report. So we think this corroborates what we have in the Trustees Report.

On the next slide, we did add one other measure that has been mentioned from time to time by some folks, in the black bars. The black bars are quite a bit higher, but the black bars, I think we would all agree, are probably not an appropriate thing to look at for a replacement rate, because the measure of earnings for individuals that is included in the black bars is the last 5 calendar years of earnings before you start Social Security benefits.

Fifteen percent of our beneficiaries whom we looked at in the year 2011 had no earnings at all in the last 5 years, and about 25 percent of the last 5 calendar years before people start getting benefits are zero years. So, taking the average of your earnings in the last 5 years, including zeroes, really does not give us a solid foundational basis of what we would really want to be replacing for ourselves or for other American citizens.

On the next chart, really this is just a look at what Senator Toomey addressed and what we are all well-aware of—the challenge we are facing. Senator Brown, you did mention the idea that we did have, back in 1994, our last major legislation on Social Security. We had a tax rate reallocation. You can see that on the bottom line here, how the DI program was pulled back up.

We are now approaching a point by 2016 where we are going to have to do that or something like that very soon. And we are looking at 2033 for the Social Security program as a whole.

So what are we doing to have to do? On the next slide, we just show we are going to have to, between now and 2033, do some combination of reducing the level of benefits, cutting them by 25 percent relative to what is scheduled in current law, or increasing the revenue by 33 percent, or some combination.

We have a number of ways of approaching this. In fact, we have left some copies with you all of some of the provisions we have up on the Internet. We hope that you all look at those carefully, and we might have a chance to discuss some of those.

In addition to the changes that we need to keep the solvency of the program intact, to adjust for that level shift that we have in the cost of the program from 4.3 to 6 percent of GDP, we have to either pull the revenue up to that level or pull the cost down, or something in between.

In addition, there is the other question of the strength of Social Security—not just its financial strength, but also the strength of the level of benefits, which I think Senator Brown mentioned. And we have looked at a number of different provisions that we have documented on behalf of members of Congress and others, including restoring student benefits up to age 22, providing a restored minimum benefit, which has basically withered under Social Security, doing more for aged surviving spouses, and also possible adjustments to the cost-of-living adjustment.

And with that, I will stop and pass the torch to Teresa, and I look forward to your questions and comments later.

Thank you very much.

Senator BROWN. Thank you, Mr. Goss.

[The prepared statement of Mr. Goss appears in the appendix].

Senator BROWN. Dr. Ghilarducci?

STATEMENT OF TERESA GHILARDUCCI, Ph.D., CHAIR OF THE ECONOMICS DEPARTMENT, THE NEW SCHOOL FOR SOCIAL RESEARCH, THE NEW SCHOOL, NEW YORK, NY

Dr. GHILARDUCCI. I do not have any graphs, so I am sorry. [Laughter.]

Thank you very much for inviting me, Chairman Brown, Ranking Member Toomey, and thank you for your comments, Senator Isakson.

For the first time in U.S. history, working Americans will be worse off than their parents or grandparents in retirement. It is actually a shocking number. But since Social Security's passing, we saw every generation looking forward to living better when they retired than their great-uncle or their parents. And we are now seeing a reversal. The baby boomers expect to do worse.

And much of that erosion in expectations is because of congressional action, and much of it is unintended. And I am going to talk today, and my testimony is about, the layer of income. It is not really a stool, but a pyramid. The base is Social Security, and that important second layer is employer-provided pension plans or pension plans you get at work. So I am going to include 401(k)s and their cousin, individual retirement accounts, IRAs.

What we are finding is that that layer of income is eroding precipitously. We all know that there are fewer pensions, traditional pensions, that pay out an annuity. And that is eroding very, very quickly. Older workers are coming in to retirement with much more debt. It used to be 65-year-olds, about 35 percent of them had some mortgages. Now we are seeing that 65 percent of them have some mortgages and other kinds of debt.

More seniors are going to have to work or, more likely in this labor market, just look for work. We have seen a huge rise in the unemployment of older people, over 55. And the jobs that they have—this is new data coming out of the University of Michigan—55-year-olds, 65-year-olds are worse off than they were in the 1980s and 1990s. Things are getting worse.

There is more bending, stooping, requirements for intense concentration and keen eyesight. So the jobs that older people are having to take are actually retail work, service work, and warehousing work. There are lots of stories of workers in the Amazon warehouses who are over 55.

The last reason why most Americans will not have enough in retirement, will do worse than their parents or grandparents, is because, even though there has been an increase of retirement assets under Congress's watch—we have seen the levels of income and assets in 401(k)s and IRAs increase over the past 30 years—those are increasingly skewed to the top earners, to the highest income, highest-earner retirees, and also in terms of wealth.

So even though we see trillions piled up in these assets, they are more and more skewed to the top, and it is actually unintended consequences of some of Congress's decisions over the last 20 years. Congress continues to expand the tax deductions. You call it incentives, but the idea is that, if you have more incentives, more financial literacy, you will get more and more people accumulating assets. That plan, that scheme, is a failure.

The system is also stacked against the average worker. These incentives are based on voluntary contributions, they are based on individual directed retirement accounts, they are based on commercial private-sector financial firms, and they are based on these deductions.

So this means that middle-class workers—it is not just low-income workers, it is actually middle-class workers and upper-income workers who are more likely to take out loans from their 401(k)s, these liquid assets. They withdraw money, just take out the money and pay the tax penalty during their working lives. They tend to pay higher fees because of the commercial account management. And because middle-class people and low-income people are advised to be more conservative, they get a much lower rate of return in their accounts.

So, piling all those reasons together means that Federal policy treats differently people who do identically the same thing. You have a high-income worker and a middle-class worker saving the same amount in their retirement account, but the higher-income worker gets a higher net-of-fee, net-of-tax benefit rate of return.

Take out an Excel spreadsheet. Look at those rate-of-return differences over just a few periods, and you get that higher-income worker getting, because of the structure of the system, a higher rate of return. And, even though they contributed equally, the higher-income worker has 15, 20 percent more in their retirement accounts.

I know that is an unintended consequence of the way you built this system, but it does not add to any retirement income security, and you provide these lopsided benefits to people who need them

the least. It is a very ineffective way of using the $150 billion in tax deductions.

So I also have seen many polls over the last 30 years, and for the first time—this happened actually a couple of years ago—our researchers who look at polling data, political scientists, say this does not happen very often, but this is the first time that the American people are running ahead of Congress, that Americans, baby boomers in their 40s and 50s, have known that retirement security is a big problem.

And it is likely voters who are likely to say this is my top concern. Increasingly, older women and higher-income individuals, and white voters, are saying that they are especially anxious about their retirement future, and they are more likely to say things are going to get worse for them as they get older. But all Americans, as Maya will talk about, working now should worry about their retirement security.

Now the solution is, and we have known this for years, to restore some of the cuts in Social Security benefits, that minimum benefits should be increased to prevent poverty among our older people. But we also have to pay attention to that layer of income that has been eroding, that income you get when you save at work. We need—and Congress can help—an appropriate, safe, and secure savings vehicle. It is not that people are not saving; it is that they do not have a good place to save.

So I propose universal retirement accounts for all Americans. Social Security is also very good at administering the premiums from workers and paying them out. We should use that infrastructure to collect money from all workers to add, on top of Social Security, universal savings accounts.

And we should take the tax deduction and make it into a refundable tax credit. For no extra money, Congress could give every worker over $600 per year. If States with income taxes also made their deduction into a refundable tax credit, you could add even more. California workers with a refundable tax credit under both systems could save over $700, $750 per year.

Like Social Security, there would be no withdrawals before retirement in these accounts. These accounts would be managed by institutional investment managers; they are the best managers available. The funds would be pooled, unlike they are now in 401(k)s and IRAs. You would have low fees, and I recommend that they be paid out in mostly annuities so no worker has to self-insure for the off chance they will live until 90.

Because Congress has not acted, seven States—California in 2012, Connecticut, Maryland, Minnesota, Oregon, Vermont, and West Virginia—are or will be in the process of studying the feasibility of establishing a system whereby private-sector workers will have money managed by their State funds or an exchange.

And this is back to the future, because, before Social Security was passed, 26 States had on the books legislation for some kind of relief for older workers, some old-age assistance act. When Social Security was passed, these States stopped their initiative.

So there is a crisis, and it is starting now as boomers are retiring. An action now, helping accumulate funds in people's retire-

ment accounts, will help reduce costs and hardships in the near future.

Thank you.

Senator BROWN. Thank you, Dr. Ghilarducci.

[The prepared statement of Dr. Ghilarducci appears in the appendix].

Senator BROWN. Dr. Fichtner, welcome.

STATEMENT OF JASON J. FICHTNER, Ph.D., SENIOR RESEARCH FELLOW, MERCATUS CENTER, GEORGE MASON UNIVERSITY, ARLINGTON, VA

Dr. FICHTNER. Thank you. Senators, thank you for inviting me here to testify this morning. And, Chairman Brown, thank you for that very wonderful, thoughtful introduction. I do appreciate it. Thank you.

My testimony focuses on two key issues: first, the extent to which we are actually facing a perceived retirement crisis and, second, how the current structure of the Nation's largest retirement program, Social Security, is contributing to the problem by providing disincentives to work and save.

From this discussion, I hope to leave you with the following takeaways. One, painting all Americans with a broad brush of a retirement crisis creates an incomplete picture of the true financial landscape faced by America's future retirees. Two, the narrative of a retirement crisis leads us to look toward greater dependence on, and the expansion of, government programs such as Social Security, which are already facing severe financial problems. And three, urgently needed Social Security reform should not exacerbate these existing problems.

The national newspapers are full of stories claiming that Americans are woefully unprepared for retirement. A recent top story on *The Wall Street Journal*'s MarketWatch was titled, "Our Next Big Crisis will be a Retirement Crisis." Similarly, an often-cited index of retirement preparedness compiled by the Center for Retirement Research at Boston College claims that, quote, "Fifty-three percent of households are at risk of not having enough to maintain their living standards in retirement."

But do these stories and statistics truly equate to a living retirement crisis? Syl Schieber and Andrew Biggs wrote in January of 2014 this year that, quote, "The story about the declining income prospects of retirees is not true." Schieber and Biggs based their argument on the fact that the data most often cited to show there is a crisis is compiled by the Social Security Administration, based on the Current Population Survey, the CPS, from the U.S. Census Bureau.

These data used by the Social Security Administration do not accurately reflect the total amount of income in retirement derived by individual retirement accounts. When instead Schieber and Biggs looked at tax return data from the Internal Revenue Service, the reported income was much higher. They quote, "The CPS suggests that in 2008, households receiving Social Security benefits collected $222 billion in pension or annuity income." But Federal tax filings for that year of 2008 show that these same households

received $457 billion of pension or annuity income, so twice as much.

This information is important because, in order to have a financially secure retirement, many financial planners suggest a replacement rate of 70 percent. The replacement rate is how much of your pre-retirement income a person will need in retirement.

Social Security was designed to replace about 40 percent of a person's pre-retirement income, with high replacement rates for low-income workers, with the remaining amount to be covered by an employer pension and/or personal retirement savings. For example, a person who earns $50,000 in each of the final 5 years leading up to retirement should plan to have enough retirement savings to generate $35,000 earned income; that is $50,000 times 70 percent. The 70-percent figure, though, includes income received from Social Security benefits.

This is just a general rule of thumb, and everybody's retirement needs are different. And the replacement rates used by the Social Security Administration, as Mr. Goss showed in his testimony, for some people may be underestimating the actual replacement rates; for others they may be accurate.

Please do not misunderstand me, though. I am not arguing that everybody has adequately saved for retirement. Obviously, that is not the case. Nor am I arguing policymakers should not focus their efforts on policy options that will help Americans save for their retirement. But I do want to stress that painting all Americans with the broad brush of a retirement crisis creates an incomplete picture of the true financial landscape faced by America's retirees.

Further, I am concerned that the narrative being told of a retirement crisis is leading us to look toward greater dependence on—and, again, even expansion of—existing government programs, many of which, Social Security included, are already facing severe financial problems.

This is simply not a sustainable plan. We must turn instead toward policy options that will encourage individuals to work, save, and invest so that they can build their own financially secure retirement. It is important that any reforms remove the negative effects on labor force participation, improve work incentives, and promote individual savings.

As I have discussed in previous congressional testimony, Social Security reform, one, must begin immediately. And possible reforms include things like basing future cost-of-living increases on a different CPI, whether it be a chained CPI or a chained CPI–E; gradually raising the early and full retirement ages; increasing the delayed retirement credit; adjusting the benefit formula; constraining the non-working spousal benefit for high earners; providing payroll tax relief to seniors; increasing access to private accounts or private retirement arrangements through employers; and increasing financial literacy.

Social Security faces real and increasingly urgent financial challenges. Reform is not only the wise thing to do, it is the critical thing to do to ensure that Social Security remains solvent and fiscally sustainable and continues to provide retirement security for generations to come.

Senator, in my remaining few minutes, I would like to just highlight also something you brought up in your opening remarks about Social Security being an insurance program. I think that is the exact way to think about how we should look at reforms. What are we insuring against? Originally it was to insure against old age. We are all now growing older; in fact, we are living longer than the program was originally designed to have people live.

How do we make sure that it really is an insurance program that is there for those who fundamentally need it, but does not provide a greater benefit for those who already have assets? We should consider things like a minimum benefit or consider things to help those in the lower-income range, but also look to what we are doing on the high-income range and make some adjustments there as well.

I thank you for your time and this opportunity to testify today, and I look forward to your questions.

Senator BROWN. Thank you, Dr. Fichtner.

[The prepared statement of Dr. Fichtner appears in the appendix].

Senator BROWN. Dr. Rockeymoore, thank you for joining us.

STATEMENT OF MAYA ROCKEYMOORE, Ph.D., PRESIDENT AND CEO, CENTER FOR GLOBAL POLICY SOLUTIONS, WASHINGTON, DC

Dr. ROCKEYMOORE. Good morning, Chairman Brown, Ranking Member Toomey, and Senator Isakson. Thank you for inviting me to speak on a matter of critical importance for our children, our workforce, and our Nation.

Mr. Chairman, there are four big reasons why strengthening Social Security is critical for tomorrow's retirees. The first is the well-documented retirement crisis that has gotten progressively worse over the past few decades now. Teresa Ghilarducci has already outlined that.

But the fact that half of the Nation's population does not have access to retirement benefits through their jobs is a structural problem. There is also a critical concern that public-sector pensions are going to go by the way of the private sector with regards to defined contributions, and that is going to increase risk for individual retirees and also put more pressure on Social Security.

Second are the additional structural factors in our labor market that shut out more than 38 million Americans from employer-provided retirement coverage and who suffer from downward pressures on wages that make it difficult to save.

Third is the generational impact that the Great Recession has had on the retirement prospects and earnings potential for younger workers who have lost almost half of their already-low levels of wealth.

And fourth, with the number of older Americans expected to increase to over 77 million by the year 2033, and with the dramatic growth of households of color who experience a racial wealth gap that leaves the typical African-American and Latino families with only 6 and 7 cents of wealth for every dollar owned by the typical white family, it is clear that a majority of the Nation will continue

to rely on Social Security for much of their retirement income well into the future.

For these reasons, it is imperative that our Nation's leaders focus on strengthening and expanding Social Security so that we can increase the adequacy and relevance of benefits to meet changing population needs.

Decades of stagnating wages and the effects of the Great Recession have imposed financial hardship on all workers, but have had an especially detrimental impact on vulnerable workers who may never make up what they lost due to unemployment and underemployment. As a result, Social Security's modest benefits need to be increased across the board to meet the projected income needs of future retirees who have been harmed by macroeconomic factors beyond their control.

We must also provide an extra boost in benefits for the very old, the very poor, and widowed spouses, all of whom are vulnerable to poverty in their retirement due to low wages, absent pensions, poor health, the inability to continue working, and/or the likelihood of outliving other resources.

And at this point I would like to reference Dr. Fichtner's remark that everybody is living longer. The fact of the matter is that only half of the people in the income distribution, the upper half, the wealthier portion of our population, are living longer. For the bottom half of the income distribution, their life expectancies are stagnating and, in some cases, even reversing.

We are seeing startling information coming out from population researchers showing that, for the very low-income, especially white women without a high school education, they have experienced a reversal in life expectancy, over a recent 20-year period, of 5 years.

That is a stunning outcome. A reduction in life expectancy is a stunning outcome for a nation that is supposed to be the richest in the world. And it is important to ensure that the value of Social Security benefits keeps pace with increases in inflation by calculating cost-of-living adjustments using the CPI–E, a more accurate measure that accounts for the higher medical expenses shouldered by seniors.

It is also important to strengthen the program by extending or restoring benefits to new groups. Caregivers play a vital role in society, but are often forced to work part-time or take time out of the formal economy to tend to sick children or sick relatives or small children. The Social Security benefit formula should include a family service credit that allows caregivers to accumulate imputed earnings equal to one-half of the average annual wage for each year they have zero or minimal earnings, up to a total of 5 years.

Comprehensive immigration reform should provide a pathway for hard-working immigrants to receive Social Security benefits, while improving the program's actuarial balance over time.

Social Security should extend benefits to same-sex couples and their dependents, regardless of their State of residence or the location where their marriage ceremony occurred.

And we must restore the benefit that once allowed young people to continue receiving Social Security through the age of 22, as long as they remain enrolled in college or vocational school.

Finally, the changing needs of the American public dictate that we also look for new and dynamic ways to meet their needs. Although the Family and Medical Leave Act was a revolutionary step forward by requiring covered employers to allow workers job-protected, unpaid time off for specific medical and family purposes, it remains a financial hardship for many workers to take unpaid leave.

Establishing a national paid family and medical leave program as a part of Social Security would provide partial wage replacement for workers across the country who temporarily need to take time off from their jobs to tend to their own medical condition, to care for an ill family member, or to take care of and bond with newborns or newly adopted children.

In conclusion, Social Security has helped provide economic security for American workers and their families for 79 years. Given the multiple factors undermining retirement security for future retirees, it is imperative that we adopt strategies that can strengthen and expand Social Security to meet the needs of an increasingly diverse and economically insecure 21st-century workforce.

Mr. Chairman, thank you again for this opportunity to present this critical information.

Senator BROWN. Thank you, Dr. Rockeymoore.

[The prepared statement of Dr. Rockeymoore appears in the appendix].

Senator BROWN. I have only one comment, then I want to turn to Senator Toomey, who needs to leave, and he can do his series of questions first.

Your comment that one-half of the population is not living longer is so important in this debate. Dr. Fichtner talked about the media presentation of all these issues, and, while I do not fundamentally agree with all of that, I think he is generally right that people do not really understand this, are not getting the complete picture.

But one major part of that incomplete picture is that it is not everybody in this society who is living longer. The woman working the diner, the guy working in the steel plant, the people working construction, especially if they are not union-protected, so often are not in fact living longer. So thank you for that.

Senator Toomey?

Senator TOOMEY. Thank you, Mr. Chairman. Thanks very much for allowing me to go first on the questions. I appreciate that.

I just want to follow up on that very same point because, in my view, it underscores one of the flaws in the design of the Social Security program. Dr. Rockeymoore is exactly right that lower-income workers have not enjoyed the extension of life expectancy that others have.

Lower-income workers also tend to enter the workforce at an earlier age. They tend not to have gone to college, so they are in the workforce earlier. So they work longer, and they pay into the system for a longer period of time.

And, if they have the misfortune of dying in their early to mid-60s, which is not terribly uncommon, they collect nothing. They have nothing—nothing to pass on to their kids, and nothing to show for the decades they spent paying into the system, which is one of the reasons why a reform that includes accumulated savings

has a huge advantage. It does not ensure that they are going to live longer, but it would at least give them something to pass on to their kids, and maybe help to lift the next generation out of poverty.

I want to point out now that Mr. Goss, in his testimony, mentioned the fact that Social Security is by its nature an annuity. That is, of course, correct, and a lump sum of savings is not. But of course you would agree that a lump sum of savings could be used to purchase an annuity. These are readily available in the commercial market, correct?

Mr. GOSS. They could. But they, at this point, rarely are, unfortunately.

Senator TOOMEY. That may be, but they are available. And it might well be that people ought to be more aware of it—that the purchase of an annuity is readily available to anyone at retirement age.

I also had a question about—CBO, of course, has famously concluded, their estimate is that, as a result of the Affordable Care Act, we will have 2.5 million fewer people working within 10 years than we otherwise would. If they are right—if that analysis ends up to be true and the workforce is 2.5 million people fewer than it otherwise would have been—is that helpful to the Social Security program, or is that, on balance, harmful to the Social Security program, Mr. Goss?

Mr. GOSS. Well surely, if we have fewer people working, that will not only result in less revenue coming in, but it will result in less benefits payable to those individuals in the——

Senator TOOMEY. But if you factor that in, does that make the actuarial numbers look better or worse?

Mr. GOSS. That would not help. I would suggest, though, that our projections, our projections for the Trustees, have not incorporated that kind of reduction as a result of the Affordable Care Act.

Senator TOOMEY. Right.

Dr. Fichtner, I wonder if you could address the tax side of this. As you know, when Social Security was launched, the payroll tax was 2 percent on the first $3,000 a person earns. Now, of course, the value of a dollar has changed a lot. My understanding is that $3,000 back in that day is equivalent to about $52,000 today.

But now we tax 12.4 percent on the first $117,000, so we have had huge, huge increases in taxes. Is it your view that we can continue to raise taxes and indefinitely postpone a day of reckoning here?

Dr. FICHTNER. Senator, that is an excellent question. And no, it is not my view. Unfortunately, I think what you get—there is an old saying in economics that, if you tax something, you get less of it. If you raise taxes on labor, you are going to get less labor.

And it is a general statement. But I think we start seeing now, if you think about the 12.4 percent for Social Security, that does not include what we are paying for Medicare taxes as well and some additional taxes under the ACA for investment earnings that go to Medicare.

You will get someone in the 28-percent tax bracket federally, who lives in the District of Columbia where I live, and you start adding in the payroll tax, which is now 15 percent or more—we include

Medicare—then add in the 10-percent State tax. If we start raising the payroll taxes, you start getting to the point where the marginal tax rate is over 50 percent for some people. That means you are keeping, at the margin, less than half a dollar earned, and at that point people start reducing their labor supply.

I actually teach at two universities besides George Mason, at Georgetown and Johns Hopkins, as an affiliate professor, and I get paid as an adjunct, so it is an additional class. And I am often asked by those schools, would you please teach one more class this semester? And they offer a wage.

At this point now, I am keeping about 53 cents on the dollar. And it is to the point where I have said, I am a threshold earner. I do not think I really can—there is work and leisure, but when you raise the taxes on work, I start saying my leisure is worth more. And I think we would see that, in some ways, across the economy if we raise taxes too high.

Senator TOOMEY. Thank you very much.

Thank you, Mr. Chairman.

Senator BROWN. Thank you, Senator Toomey. Thanks for your insight and comments.

After listening to the four of you, obviously, there are a number of things you say in common, and some are in consensus and some not.

And, Dr. Fichtner, you made comments about the media, that this retirement crisis that our country faces is narrower than I think the other three witnesses—or at least the two flanking you directly—would opine, I guess.

But I do think we can agree—I think it was Dr. Rockeymoore who said that half the people in this country do not have a retirement program of any significance. Seventy-five percent of Americans have less than $30,000 in their retirement accounts. The median 401(k) account balance in 2011 was $16,000. Every number you look at paints a picture that there are a huge number of people in this country who are not prepared for retirement in any significant way.

I understand Dr. Fichtner's view that that does put pressure on the public pension system to do more. It puts political pressure. A number of us think that is the right way to do that, that there should be pressure there, I think. We heard that certainly in Dr. Rockeymoore's comments.

So let me ask this question. Dr. Fichtner, Social Security gives workers an incentive to retire early, because only the first 35 years of your earnings are factored into benefit calculations.

From the four of you, is there any evidence that Social Security discourages workforce participation?

Do you want to start, Dr. Ghilarducci?

Dr. GHILARDUCCI. Yes. There is no model that convinces me in economics that we are anywhere near the tax rates that would discourage labor force participation. There is a tax rate that can be too high on work, but we are nowhere near that.

There are lots of suggestions that the Earned Income Tax Credit and the Social Security system encourage people to work legally, to work on the books, to be a part of the regular workforce. So there is lots of evidence that the Social Security system, with the Earned

Income Tax Credits, puts people into the system. They do not work underground.

Senator BROWN. Mr. Goss?

Mr. GOSS. I guess I would just add that any time we offer a benefit under a particular circumstance, whether it is people reaching a particular age where they can retire or a benefit where they can receive a benefit should they become disabled, that on the margin, as economists would say, that might tend to cause fewer people to be working than would be the case if there were no such benefits available at all.

If no such benefits are available at all in retirement, people really have no choice then but to depend upon friends and relatives or to continue working, and we would have some additional work happening.

However, I would just add this. Where we have Social Security benefits, the structure of the system now is such that when people reach age 62—and I wish that Senator Isakson was still here, because the 1983 amendments to Social Security did not change the minimum eligibility age for retirement benefits from 62. So he could still start receiving benefits at 62, except that we do have a retirement earnings test that applies at age 62 up to age 66 now. If you earn well over $15,000, your benefit will be reduced and maybe even zeroed out, in effect, during the time in which you have those earnings.

However, this is not a tax. This is not lost income, because, if you have your benefit reduced due to the earnings test, we simply recalculate at Social Security the level of your monthly benefit later. It is, in effect, that you are deferring the start of your benefit, and you will receive a higher monthly benefit for the rest of your life.

So it is actually a good thing. It is, in fact, as many people pointed out—I am sure everybody on this panel has—one of the best ways that people can possibly avail themselves of a life annuity and perhaps about the only place where you can get a CPI-indexed life annuity, and that is to start your Social Security benefits at a later date. For people who are working at substantial earnings levels above 62, this happens automatically.

So I would suggest, in that case, we should not think rationally that Social Security is a deterrent to people working. In fact, if anything, the fact that your benefit will be enhanced so greatly for the rest of your life if you work between 62 and 66, we should actually look at Social Security as potentially an encouragement to such work.

Dr. ROCKEYMOORE. I would like to add on to that qualitatively. In terms of our experience, we have found that individuals who perhaps work at the State and local level and do not have access to Social Security through their State and local coverage actually want to work an additional number of years and hours to make sure that they can actually qualify for Social Security benefits upon retirement.

For low-wage workers who know that their jobs either do not provide retirement benefits or disability benefits, they are striving towards meeting Social Security credits, or quarters, so that they can make sure that they have access to retirement benefits or dis-

ability benefits, should they need them. And so it is important to note that.

I want to also say to Mr. Toomey's point about people dying at a young age and then having no way to leave behind any benefits for their dependents or survivors, the fact of the matter is that Social Security actually does that.

And, when you look at the difference between how whites use Social Security and how African-Americans use Social Security, you see the distinction. For whites, more than 70 percent of white people use Social Security for retirement benefits. But for African-Americans, it is just a little over half. The other half of their Social Security benefits are paid through disability, and a large chunk is through survivor benefits. So, when African-American men, who have the lowest life expectancy of most workers, die, and they die young, they are actually leaving young dependent children behind. And the benefit that those children then end up receiving in survivor benefits is significant. And you see that reflected in the racial differences in survivor benefit receipts.

Dr. FICHTNER. Senator, I would just sort of echo that, because Mr. Goss actually said the very important term, which is the economics are "at the margin" and how people respond to incentives or taxes at the margin.

If you take a primary worker—if you raise, for example, my Social Security payroll taxes, I am not going to quit working. I have a mortgage to pay; I have a life to lead. I want to keep working, but maybe I cut back again on those teaching jobs which, at the margin, are extra income.

You also see this having an effect on second earners, spouses. A lot of times it is actually women who find that they are trying to take care of a child at home, and all of a sudden the extra taxes they have to pay in payroll taxes, as well as the child care—now actually the child care cost exceeds what they are paying in and getting on a net tax basis, because they are paying payroll taxes, Federal taxes. There is sometimes a marriage penalty for some earners. So there is a disincentive in some ways, and this goes to the point where I think we need to think about it holistically.

I think we would all agree here we want to help those who truly need assistance, and I think that is the underlying point about social insurance. There are people who, it may be no fault of their own—you know, they had hard jobs, they cannot work past 62, they have had low wages and could not save, and, as both my colleagues have shown on either side of me, they do not have access to a retirement plan.

That in some ways is not trying to reform Social Security. That is not how we reform the tax code. So, as Dr. Ghilarducci pointed out, let's not give a deduction for a 401(k); let's change it to a credit so it actually helps low-wage workers.

We should do that with our housing policy. We give a deduction for mortgage interest paid, which I will say I get a large benefit from. But I am not the person you need to encourage to buy a home. I am already going to buy one.

We need to help lower-income people buy houses, because that is a large asset which helps them save for retirement in some ways. Let us change the mortgage interest deduction to a credit or a re-

fundable credit so that they get the benefit of home ownership as well in that asset purchase.

We need to think about retirement security as more than just Social Security as a program. We need to think more holistically about how we actually change our culture of debt, consumption, savings, housing policy, the tax code.

This all comes together around what we think is now the retirement crisis and who it is actually affecting, whether it is low-income, high-income, middle-income people, minorities. This is very important. I think we should look at this as a holistic package.

Senator BROWN. Thank you.

With that comment—I appreciate those thoughts.

I want to talk about meeting the needs of workers with long careers and low wages. All of you have touched on that in a variety of different ways—all of you, really creatively.

We know the replacement rates for low-income workers are relatively progressive, compared to the rates for wealthier taxpayers. The benefits for workers with average wages—the replacement rate is 42 percent. For low-income workers, the replacement rate is as high as 77 percent. But the cash benefit is still far too low for a long-time, low-income worker, and that is clearly a big part of the problem here.

The benefit to low-income workers results in, far too often, still living below the poverty line. Modernizing the special minimum benefit would address this problem. The minimum benefit is ineffective because, indexed to price inflation, it has risen more slowly than regular Social Security benefits indexed to wage inflation.

How do we modernize the benefit so that a $10-, $11-, $12-an-hour worker at a fast-food restaurant or working waiting tables at a diner or people who are in that wage category, how do we modernize, if you will, the benefit so it meets their needs?

If you would, Mr. Goss, do you want to take that first and then go across the table?

Mr. GOSS. Wonderful. Yes, thanks very much, Senator Brown.

The point you are making here, the point about differential lifespans and mortalities, differential earnings levels, all of these really sort of fit together. And I think what everybody has described so far about the nature of the Social Security benefit formula really does fit into this issue. The fact that we have the higher replacement rates, higher benefits relative to the earnings that people have had at the lower end of the earnings spectrum, speaks to, really, these needs in many, many ways.

First of all, the obvious, is that people at the lower earnings levels generally are much less participating in saving towards retirement and much less likely to have a 401(k) or a defined benefit plan from their employer. Also, it is the lower-income people who tend to have had less progress in improvement in mortality. So, having a higher monthly benefit relative to the amount of earnings that people had in the past is a way, even beyond these sort of holistic points that Dr. Rockeymoore was describing for disability and survivor benefits, to more equalize the kinds of benefits people get over an entire lifetime.

For people with lower earnings who live a shorter amount of time, the fact that they get a higher monthly benefit if they live

a shorter amount of time will also more equalize what they are getting. And so, as to the minimum benefit, we have seen many, many proposals about the minimum benefit, because our special minimum benefit, as you described the CPI index, has fallen into being virtually not applicable at all now.

So we have seen in many different proposals, both the Simpson-Bowles proposal and the Bipartisan Policy Center proposal as well as others, the idea of restoring perhaps the wage index to a level of minimum benefit.

But to the notion of retirement age, let me just add one other thing that is in the Simpson-Bowles plan, and we worked very closely with that Commission. And one aspect that they were looking at was the possibility of raising the retirement age, but they wanted to find a way to raise the retirement age such that people with long careers at low income would not be as much affected and possibly not affected at all.

And we worked with them on exactly that. People with 30 or more years, who are below 400 percent of poverty in their average earnings levels, would be affected less. And, if I recall, those below 250 percent of poverty in their average earnings, at least——

Senator BROWN. So, is it right——

Mr. GOSS [continuing]. Would not have the retirement age increased at all.

Senator BROWN. Is it the right public policy—and I am still very taken by a couple things Dr. Rockeymoore said. Is it the right public policy that to ultimately end up in this place, that low-wage, lifetime workers—and Dr. Fichtner said, I think it was he who said that a low-wage worker often gets into the workforce earlier than a higher-wage worker, for starters.

But do we want to get to the place where the lower-wage worker whose life expectancy is less, we know that, that that lower-wage worker then—should we build more progressivity into the benefits structure, whether it is the minimum benefit or just more progressivity than we already have? I do not know that the public knows that Social Security is redistributive and the degree to which it is, and some would argue that it should be more so.

Is there a way to get Social Security to predict sort of, actuarially, people's life expectancy? Demographically, someone who goes to college is likely going to live to be 82 versus somebody who worked at a fast-food restaurant much of their lives in low-wage jobs, who is more likely to live only to 62 or 72.

Is there a way to build a progressivity in there so that their benefits, if you will, are more front-loaded, knowing that the 82-year-old will draw fairly high benefits for a longer time? Is there a way of building that in?

Dr. Ghilarducci, you are nodding.

Dr. GHILARDUCCI. Yes. My research right now is on exactly that, that low-income workers start early, end earlier, and die earlier. And so, raising the retirement age blanketly is a bad idea. That is in my written testimony. It is a bad idea because of these retirement age differences and these longevity differences.

But let us step back. We do wonderfully in equalizing retirement time for low- and high-income workers in our system. It is really quite brilliant. And the way we do it is, our disability insurance

kicks in for workers who are depreciated, are worn out in their early 50s.

With an administrative law judge in a disability hearing, the administrative law judge takes into account their work options. So it is their disability as well as their future in the labor market. And we have constructed a system where low-income workers are retiring earlier, getting disability until they reach retirement age and they get Medicare. And that is actually——

Senator BROWN. If I could interrupt, that is the importance of doing reallocation right, correct?

Dr. GHILARDUCCI. That is, because reallocation is all of a system. Dr. Fichtner talked about that; the system works holistically as social insurance to take care of people in different life circumstances.

The other clever idea——

Senator BROWN. Disability insurance has never kept up, in terms of payments, with Social Security benefits, correct?

Dr. GHILARDUCCI. Right. There have been a lot of administrative and regulatory decisions that make it harder and harder for people to get on disability. And that can be changed with, actually, regulatory changes.

So it has not kept up, but it used to. And so we see current retirees now having the same amount of retirement time, even if they earned low or high wages.

There is also this idea of longevity insurance, so that people would get a kicker if they are at age 80 or if they are impoverished. There are proposals to add a new benefit. I am on the Bipartisan Policy Center's commission now, and we are going to be looking at minimum wage.

But I still want to leave you with—there are lots of ways to prevent poverty. It is affordable for our older population, and it is not just for lifetime low-wage workers.

Senator Brown, you know more than almost anybody here, because you are from Ohio, that the labor market has really jumped around. Industries that were supposed to live for a long time are now dying. And so middle-class workers, college-educated workers, can drop down into these low-wage jobs for a long time.

The United States creates more low-wage jobs than any other country in the OECD. So it is not just people we do not know; it is actually people we do know who are——

Senator BROWN. Let me back up on that statement, we create more low-wage jobs. Is that because our minimum wage is set so low, or is it a function of a service economy versus manufacturing, or——

Dr. GHILARDUCCI. It is all of that. It is also the erosion of unionized jobs and union protections. So jobs in those industries—service sector; manufacturing; fast food workers, if they were unionized; textile workers, from where I am from; rubber tire workers from where you are from—if they were unionized, those jobs earned a lower-income, middle-class wage. And with the erosion of unions and the minimum wage together, we lead the world in the creation of low-wage jobs.

Senator BROWN. Dr. Fichtner?

Dr. FICHTNER. Senator, I would like to just add to my two colleagues' comments, and keep in mind that a reform based on your concept in your opening statement is about insurance.

Are we insuring against poverty and old age, or are we insuring against living too long? What are we insuring against? This program was not designed to be a retirement program for all; it was designed to be social insurance.

And I think we need to keep that in mind and think about what we mean by "minimum benefit." That is, if we are insuring against poverty in old age, consider both the low-end income near retirement and at retirement.

But again, as Dr. Ghilarducci pointed out, those who might hit 80 or 85 would literally have found that they have now outlived their savings. That is the insurance on which Social Security originally started—again, old-age insurance. We should consider both angles.

And I think if we look to reform, if we are going to make the system more progressive—which in general I am for—you have to give to some, but you have to take from some. And I would look to the higher-income earners in some ways who may not need Social Security as much, or depend on it as much as lower-income earners, to balance it out. And we should try to make it sort of revenue-neutral so that we do not exacerbate the current program finances. That is the Social Security side. But again, I want to focus on the holistic nature.

President Obama has proposed the myRA accounts, or my-R-As. Senator Rubio, your colleague, last week proposed opening up the TSP plan, which government employees and members of Congress and Senators have access to, to the public.

Again, to hit those 75 million Americans who do not have access to a retirement vehicle, we need to make sure they have access to a retirement account in some way, shape, or form, whether it is TSP or TSP-like or a myRA—something so that you start getting people to save and invest.

When I was working at Social Security, Steve—and I give him a lot of credit for this—helped me out a lot in helping the agency move our financial literacy efforts and change the publications we were doing, the messaging we were working.

And I found this in my drawer as I was preparing yesterday. Steve, I do not know if you remember this one, but Senator, I will give you a copy at the end. We created these little cards. One is wallet-size and one is larger, and they basically show the benefits of delaying Social Security, how much more you get per month past 62, if you delay from claiming. And it also shows the value of saving just $2 a day. And again, $2 a day comes up to about $600 a year, a little more than that, Dr. Ghilarducci was pointing out.

And we started giving these to people at field offices and events we would do, and people would play with the slide rule. It was an old-fashioned slide rule many of you have seen before. And it is changing, again, how we look at financial literacy and trying again to promote savings.

And I just wanted to encourage again a more holistic picture. Let us make sure we help those who really do need the help. And Steve

mentioned the idea of even working with the Simpson-Bowles Commission on raising the retirement age.

I am for that, but again, I want to make sure we protect those at the low-wage end who, again, have worked in blue-collar jobs their whole life, maybe cannot work past 62.

I am 42 years old. I think I am fairly well-off, but there is still a very good chance I could become disabled at some point in my career. Social insurance disability, Social Security, is there for me as insurance if I get disabled. We need to make sure those insurance portions are protected as much as possible.

Senator BROWN. The fact that you are 42 years old means you can read the small print on those cards. [Laughter.]

Dr. FICHTNER. I will give you the big one, Senator.

Senator BROWN. Mr. Goss may be older than that. The other two, I think, are younger than 42, way younger.

Do you want to say something? Because I want to ask him a question. But go ahead; then I want to ask Dr. Fichtner a question about what he just said.

Mr. GOSS. I would just like to respond, first of all, to your point about redistribution. We have voluminous proposals for having the Social Security benefit formula being further redistributed—in fact, one that was supported by President George W. Bush, something we call progressive indexing, which would, to the extent that benefits will be lowered in the future to right the financial balance for Social Security, would be done only for people at higher levels.

But I would like to address one other thing that——

Senator BROWN. That does nothing to redistribute money to lower levels; it just, quote-unquote, "fixes Social Security" by taking a little from the upper-income.

Mr. GOSS. Exactly right.

But I would like to address a point that Dr. Fichtner has made here two or three times, which is about Social Security being a mechanism for providing benefits just to those who really need it. And I would like to draw a distinction here between social insurance and welfare programs.

The Social Security Administration administers not only Social Security benefits, but also the SSI, Supplemental Security Income program. That is a means-tested program, as we all know. And Senator Brown, as you pointed out, that has not been well-indexed over time, in many, many respects.

But Social Security, from its very foundational start, was designed to be an earned-right benefit for all Americans. It really is provided for virtually all Americans. Over 95 percent of Americans will expect at some time in their life to get some kind of benefit from Social Security.

Now, it is differential. People get a higher rate of return who are lower-income, or at least a higher replacement rate, but its basis has been to provide benefits for all, even including people who might be extremely wealthy. We have no means test, at least currently, in Social Security. That is a possibility. That could be done in the future.

But I would like to draw that distinction between social insurance and a welfare program which would provide benefits only for

those who, as I think Dr. Fichtner was describing it, really need it.

Benefits are provided for people of very good means. When Dr. Fichtner reaches 20 years hence, at age 62, he will be eligible for benefits, even if he has massive income and resources at the time.

Dr. FICHTNER. I will delay until——

Mr. GOSS. And when he reaches the so-called normal full retirement age, we no longer even have an earnings test. At the full retirement age now, you can earn as much as Bill Gates or as much as Dr. Fichtner and I hope to be making at that age, and still receive your full benefit.

So I really just did want to——

Senator BROWN. And I appreciate your comment. I think all of us, regardless of politics—well, I think there are some number of people probably in this body or the House who do not really fundamentally appreciate social insurance.

But I think surely the great majority of the public understands the concept of social insurance, whether they call it that or not, and understands the importance of it and does not want it fractured or violated.

That always brings me to the cautionary note. While a number of us here want to see a more redistributive, a more progressive Social Security system, it does lead us to not want to means-test upper-income people, because it does fracture the universality of it, and it does speak to the caution of, you do not want to change Social Security to a welfare program. You did not use that term, but that is kind of what you are implying.

So my question for Dr. Fichtner is, and then I have a couple of questions for Dr. Rockeymoore, is there a way to—you mentioned that you would support raising the retirement age. You did not get to particularly for whom you would raise it, but that is where I want to go.

Would you support a way of raising the retirement age for the top fourth or third or half of high-income people? And I am not asking you to be too specific here, but might we be able to, in essence, as Dr. Rockeymoore suggested, in some sense lower the retirement age for low-income workers by filling it in with disability and other kinds of benefits, but making them actual above-the-poverty-line benefits?

Is there a way for a more conservative, politically conservative, viewpoint here to get to that place?

Dr. FICHTNER. That is an excellent, nuanced question, Senator. Let me give you an excellent, nuanced answer, because the answer is "yes."

And what I would do, though, is, instead of trying to focus on raising the retirement age for one group over another, you do raise the retirement age for all, but you focus on raising up the minimum benefit for those who are forced to retire or do retire at 62. And you might even encourage having a higher delayed retirement credit for those who work past 66 or 67, as they go towards age 70.

That is one way to do it to make sure there is a minimum benefit that is higher, so that, for those people who actually, again, work physically demanding jobs and need to retire early, cannot work

longer, that benefit level is above the poverty line or higher. But you still then have an incentive in some ways to work longer, if you can.

And I would also throw in there an idea that has been floated, again by Senator Rubio and others, about whether or not, if you reach a certain age or a certain number of years of paid service, you would no longer pay payroll taxes. And this is something that would encourage work, as well as savings, in later life.

So, picture a low-income worker who might start working—does not go to college, but starts working a blue-collar job at 18 years old. They are going to pay payroll taxes every year in which they work. You could do something that says, after 45 years of paid-up credit—which would put them about 61, 62 years old—they will no longer have to pay Social Security payroll taxes. They could continue working at that point and actually keep all that money for savings.

That would be an incentive, one, to continue working, so that would actually support labor incentives. But it also would help people, lower-income workers, as well as higher-income workers, to save.

Senator BROWN. Would you support—and I do not know if Senator Rubio has thought it through in this direction. Perhaps—is there a way, say, after 40 years, you no longer pay the Social Security tax, but you put it in an account that the government matches? Say it is sort of an enhanced Earned Income Tax Credit that can then begin to build savings.

So that is something you could see, sort of across the political spectrum, there would be support for.

Dr. FICHTNER. Yes. I think, Senator, that is a good way of looking at it. And some have argued, in thinking about the enhanced Social Security—and Teresa has mentioned this too—there is a lot of opposition on one side to raising payroll taxes. The taxes are too high as it is; do not raise them too much.

But some have argued, again, on the conservative side, do private accounts as the add-on. So, if you are currently doing 12.4 percent for payroll taxes, make it 14.4.

Senator BROWN. But it would be private accounts.

Dr. FICHTNER. But the 2 percent would go into a private account. That is ownership that encourages savings, whether it is through a TSP plan, TSP-like, Fidelity, something. You are now encouraging savings.

I think the big issue that all of us would agree with is that, in some way, shape, or form, regardless of how we do or do not reform Social Security—and it does need reform—we still need to focus on people's ability and access to savings. And they do need to save.

Senator BROWN. Thank you.

I have a couple of questions for Dr. Rockeymoore, but Senator Nelson is here.

Senator Nelson, take as much time as you need.

Senator NELSON. Thank you, Mr. Chairman.

I have the privilege of being the chairman of the Aging Committee. And we have had a number of hearings that have discussed Social Security. What makes Social Security great is that virtually every worker pays into it, but a worker has to hope that his em-

ployer offers a retirement plan. And for a variety of reasons, many do not.

Senator Collins, my co-leader on the Aging Committee, and I have tried to make it easier for small businesses to pool together and offer plans. But we do not think that that, as a practical matter, is going to give every worker an at-work option.

So I would like to ask Dr. Ghilarducci—you have been very vocal about creating a mandatory and universal retirement account that is professionally managed. Last week my colleague from Florida, Senator Rubio, shared his desire to allow Americans without a retirement savings plan at their work to sign up for our Federal Thrift Savings Plan.

So can you talk a little about what the States are doing and what you think about Senator Rubio's idea?

Dr. GHILARDUCCI. I think Senator Rubio has a good idea. I think this may be a truly bipartisan issue.

We all know—and it is just math—that we have to save for our retirement. Twelve-point-four percent goes automatically; it is a mandatory system, Social Security. All of us who are in pension plans at work save the extra 8 percent, so we all need to save about 20 percent, all totaled.

And half of Americans are not doing it, because their employers are not offering a plan. And there is no sign that that is ever going to get better, despite all the financial literacy and all the marketing by Fidelity and all the other plans. It is just not working. And Congress can pile on more tax deductions, but we are not going to get universal coverage.

So I, and it looks like Senator Rubio, are recommending that we mandate extra coverage and make sure that people can use a professional pension system.

The States are not waiting for Congress. Five States have already passed laws of some sort to get their private employees into a system that is managed professionally, based on pooled assets, with annuities that prevent them—because we are the only nation on Earth that allows people to withdraw retirement assets before retirement. What other nations call retirement assets, they treat like retirement assets, and people can only get at them at retirement, a thought we have not endorsed.

So I approve of a mandatory tier. I think it is much better to do it at a Federal level, but, like lots of social policy, the States often move before the Federal Government does.

Senator NELSON. This idea that if you are a small business, you really do not have enough wherewithal to provide a retirement plan, getting small businesses to pool together to do that, is that pie-in-the-sky?

Dr. GHILARDUCCI. No. That is actually what drove the legislation in California. The small businesses realized that they did not want to deal with the 401(k) brokers and administrators, or the complexity. They did not trust that the 401(k) system or IRAs gave the best deal to their employees. And, since it was voluntary, they just walked away from it. So they encouraged the legislation in California to provide an automatic enrollment into a private system.

So this helps small employers that might become medium-size and large employers get a pension system to their employees and

to themselves, because a lot of small businesses also want a plan. If you start early saving for retirement, you do much better, and it is a lot cheaper.

Senator NELSON. Are there other States that have a similar kind of law like California?

Dr. GHILARDUCCI. Four others, and I go testify in these State legislatures. There are a lot of them. Fifty, it turns out. Four other States besides California have passed legislation and five others are considering it.

Nebraska and Washington State have a lot of legislation and a lot of commissions. So I would count 12 States that are seriously at some stage of creating these universal plans.

Senator NELSON. Under the present system, if you delay in taking Social Security, you increase the lifetime benefit by 8 percent for every year that you delay. Of course, a lot of seniors cannot wait, and that is a big decision.

Dr. Fichtner, you have discussed this in your expositions and writings, and you have applauded Social Security for changing course and not encouraging people to take the benefits early. But the workers out in the field offices, they do not necessarily discuss the benefits of waiting. So what should we, as the committee of jurisdiction on Social Security, what should we be doing?

Dr. FICHTNER. Oh, Senator, that is an excellent question. And I am glad I no longer work for the agency, so I can speak completely freely.

The agencies should promote what is basically an individual option for people when they come to talk about when to retire for Social Security benefits. There is not a one-size-fits-all model. For some people, 62 is the right age. They either cannot work longer, or they need the money today. Forcing them to work longer is not the right move. For others who have assets or can work longer, they may decide not to work. They still can delay claiming. Claiming and stopping work in some ways can be two different things.

The agency needs to do a better job of telling people and showing people, here are your options, here is what it means for you, and making an individual decision.

Steve Goss helped a lot when I was at the agency with language that we could use. We have a 2-pager—actually, I think the agency, hopefully, still uses it—on when to start receiving retirement benefits, which really goes through, consider your health, consider your history of your family, your genetics, your income, your lifestyle you want to have, your outside assets, and then make a determination.

You can always walk into Social Security and say, "I am thinking about taking retirement benefits." Talk to somebody. If you decide it is not the right time, you can leave. You can come back tomorrow or next week or next year, when you are 70. You have the individual choice.

And I would love it if Congress would help push that message on the agency that that should be the focusing message. We have—I keep saying "we" because I worked there—the agency has moved away from the break-even analysis which, again, with the help of Steve Goss, we were able to change so that people were no longer being told if they took benefits today at 62 they would be ahead

for 14 years. That is a problem, because, when you get to 76, you are then behind for the rest of your life. They were not getting that message. I think a lot of field offices now are getting that.

But it is a culture change, and that takes time. So the longer we put pressure on and keep giving the right message, the more we will make that change, Senator. And I appreciate your bringing up that issue.

Senator NELSON. Do I have time for one more? Do we have a vote in progress? All right.

The special minimum benefit in Social Security—it is to help low-wage workers, but, come 2016, it is not going to be indexed to inflation anymore. So how do we in Congress revamp this benefit so that it actually works as intended?

Dr. ROCKEYMOORE. So, when it comes to low-wage workers, there are two things that I think need to be done.

First of all, because of the effects of the Great Recession on the economy and the impact it has had on younger workers who will be tomorrow's future retirees, we need to boost benefits across the board for all Social Security recipients. And, when it comes to the special minimum benefit, we actually need to increase it to 125 percent of the poverty level. And we need to make sure that it is indexed also to the growth in wages, so that it is adequate.

As an addition to that, I would add that the CPI–E is important to adopt as well for low-wage workers. Because, as you well know, the CPI–W, which is the current formula that determines the cost-of-living adjustment, does not actually account for the higher costs borne by the elderly, particularly the medical costs that they incur.

And so, by also shifting Social Security COLA to use the CPI–E, this is another way that we can actually boost benefits for low-income workers.

Senator NELSON. So the chained CPI would take it exactly the other way?

Dr. ROCKEYMOORE. It would take it in the exact opposite direction, something that we actually do not need. And it would imperil not just low-wage workers, but also middle-income workers.

More than 38 million-plus members of the U.S. population who depend on Social Security for a significant portion, or all of their retirement benefits, would be harmed by that proposal. And we firmly reject it.

Dr. FICHTNER. Senator, can I add to that on the CPI?

Senator NELSON. Please. Please.

Dr. FICHTNER. I caution, and Steve may also bring this up, that, again, he mentioned in his testimony that Social Security is not just the program for the elderly. There are children, there are the disabled. The CPI–E really is for the elderly. And one of the concerns we have in looking at trying to do inflation is, how do you accurately measure inflation?

The reason that chained CPI has come up in the discussion is that it takes into account people's behavior. If oranges go up in price, they may buy more bananas, for example. So, if you are thinking about the CPI–E as a basket for looking at just the elderly, I would consider you look at a chained CPI–E, which then would take into account health care costs, but also how consumers, these

beneficiaries, would respond to changes in the basket of goods they use.

Mr. GOSS. If I could just add to that.

Senator NELSON. Please.

Mr. GOSS. There are two things that I think should really be thought about on the CPI options. Dr. Fichtner is exactly right.

The CPI–E, which is sometimes referred to as for the elderly or as experimental, is based on the market basket choices of people 62 and over.

Many of our beneficiaries are disabled, and they are under that age. However, it is likely—in fact, we believe that their lifestyle, their purchases, are probably more similar to the elderly than they are to other people of the same age who are at work. So it may well be that the CPI–E is reasonably applicable to them, perhaps more so than the CPI–W, which is just for urban wage earners and clerical workers.

If I could mention one other thing, Senator Nelson. You mentioned the delayed retirement credit—just a small point on that.

Actually, the 8-percent delayed-retirement credit for every year you defer after the normal retirement age, now 66, is actually intended to, in effect, equalize the amount of lifetime benefits you should expect to get. If you wait an extra year, you do not get benefits for that year between 66 and 67, but you will get 8 percent higher benefits then thereafter, for the rest of your life.

So it really does provide a very substantial encouragement to defer longer the start of their benefits and thereby to get a much higher benefit level for the rest of their life. And by the way, that delayed retirement credit also ports over to a surviving spouse, should you predecease your spouse.

Dr. FICHTNER. Good point.

Dr. GHILARDUCCI. We all in this room will probably take the delayed retirement credit because we all probably expect to live longer than average. But it is not a good idea for a lot of people who do not expect to live the average, and that is half of the people, because that is what the averages are.

So it is a very good deal; 8-percent return is exceedingly generous, and we are all thankful for it.

I want to caution us. When we talk about raising the retirement age, it is just a form of cutting benefits. And so, it does not seem to encourage work.

Work has its own merit. Wages—people work for wages, and people work because they are invited into the workforce by employers, or they choose to do it because it has other kinds of benefits. So just raising the retirement age is not a way to get this glorious increase in workforce. So we are spending a lot of time—a lot of us are talking about workability in conjunction with raising the retirement age.

The chained CPI depends, I think, too much on what economists fetishize in terms of substitution and choice. Because, if we choose to take an inferior product, that is not keeping standard of living the same. That is why the chained CPI has often been called the cat-food CPI, and that refers to the substitution effect.

If people substitute away from a good-quality meat to an inferior meat because of the price differential, we are still demanding a de-

crease in their standard of living. So chained CPI would reduce the standard of living for everybody who would have it.

Mr. GOSS. Could I just add, at the risk of perhaps making this far too technical, all of the CPI indices that we now have—CPI–W, the chained CPI, and the CPI–U without chaining—all work off of, I think it is 122 different strata of types of goods and services. Within each one of those individual strata, we already have substitution bias in effect taken care of.

We have this geometric means which in effect takes care of substitution issues within each stratum. So what we are faced with then on the prospect of going to a chained CPI is substitution or, I would say, redistribution of people's purchases across broad categories of goods and services.

It is not going from pork chops to hamburger; it is really more going for your big-screen TV versus the purchase of a car this year, not necessarily substitutable items. And that is where really the chained CPI gets to. People of our means do tend to make choices in those arenas, but not everybody does.

Senator BROWN. Thank you, Senator Nelson.

Let me—we have until noon. I want to ask each of you individually, or the three of you anyway, a specific question and not, unless you have something really brilliant to add to it, the others who were not asked. Keep it to yourself, all right? [Laughter.]

But I want to start with Dr. Rockeymoore.

Same-sex couples are particularly vulnerable to retirement insecurities. Couples have been treated as individuals, are ineligible for private pension and Social Security survivor benefits. The Supreme Court obviously has spoken on these issues in terms of discrimination. What policy changes do we make with Social Security?

Dr. ROCKEYMOORE. We actually need to cover same-sex couples just like we do heterosexual couples, and their dependents. They need to be eligible for Social Security benefits like any couple, regardless of the place where they got married or where they currently reside.

Senator BROWN. And that takes congressional action?

Dr. ROCKEYMOORE. That takes congressional action. And so, basically, federalizing this will be required.

Senator BROWN. All right. Thank you.

We also will send written questions. We have at least five more questions, probably, for each of you.

Mr. Goss, this is for you. If there is one area on Social Security where every Senator on this committee should agree, it is in modernizing SSI. It is a modest supplemental benefit for the elderly, blind, disabled, people of little other income. Strict eligibility requirements were put in place at the inception a long time ago. This made sense, but now those requirements, because they have not been updated, certainly need better examination.

Give us comments on proposals for this program, and what you think personally, what you think from your incredibly deep knowledge of these issues, what is necessary and prudent.

Mr. GOSS. I think that the most commonly discussed items for the SSI program are the fact that the $2,000 asset limit and the income disregards, of which there are a few, have been at fixed levels now for decades, and there has been no indexation whatever.

And most people, I think, agree that there should have been some indexation. The question is, if we were to make a change in those, should there be a level jump? Should there be a change in the levels to start with and then indexation thereafter, or just indexing from the current levels?

The other question really is the Federal benefit rate itself, which has been indexed. That is one aspect that has been indexed, but to the level of the CPI.

And, within the structure of our economy, our society, we know that fewer and fewer people, as we project into the future—Dr. Fichtner will recall models from Social Security that projected the percentage of the elderly that will be in poverty would be dropping from 10 or 12 percent a few years ago down to 2 percent 50 years out.

Why? Because we have a general, slow, and gradual increase in the standard of living in our economy, but, if you have something like the poverty threshold or SSI benefits rising only at just the cost of living, that will fall lower and lower in the income distribution.

So serious thought probably ought to be given to whether the CPI indexing alone is sufficient for SSI.

Senator BROWN. Thank you.

Dr. Ghilarducci, it is important, as really all of you have pointed out, in a sort of holistic way, as Dr. Fichtner said, that we think of Social Security as sort of a group of insurance products—the Old-Age, Survivors, and Disability Insurance program, an affordable insurance package for all Americans. Within that context, we can consider what expanding Social Security is all about, expanding social insurance to strengthen families.

Women make up roughly half the workforce. The increase in women's work hours between 1979 and 2007 led to an additional $1.7 trillion of economic output, in 2012 dollars. The U.S. is the only advanced country and economy in the world that does not guarantee women the right to paid maternity leave, I believe.

One proposal you spoke about was the Family and Medical Leave Act of 20 years ago, which was progress, but obviously did not pay for it. One proposal would create a national paid family and medical leave social insurance benefit.

What would the effect of that be on workers and on the economy, if you would give us a fairly expansive answer there?

Dr. GHILARDUCCI. Yes, sure. I really like your phrase, an affordable insurance product for all. I would add, an affordable insurance and savings product for all. That is what we can do here, because the Social Security system is so strong administratively.

I think we overlook how powerfully——

Senator BROWN. Strong means low overhead and reliability? Those two?

Dr. GHILARDUCCI. Thank you. And universality. Almost all Americans participate in the Social Security system. We do a lot better than Italy, for instance, where there is lots of avoidance of being in the formal economy.

So we really do need to give ourselves a pat on the back and really celebrate the fact that we have a system that is universal and that people participate in. I really want to stress that, because the

Earned Income Tax Credit, Dr. Fichtner, actually pays for the low-income workers' payroll tax.

So it is a brilliant mosaic of social insurance that also comes from the tax code. Do not overlook that when you are celebrating our successes.

So what you have asked me is whether or not this infrastructure—I call it a financial insurance infrastructure—that is available to all at a very low cost can be expanded to include the kind of modern insurance products that we need.

And the answer is a definitive, absolute "yes." And it should be; it is designed to do that.

So, if we recognize that family needs are changing, then the Social Security system is an appropriate place to add on new insurance products. And family leave is an excellent insurance product.

You know, it is an accident of history that the unemployment insurance systems were not administered on the Federal level. States, for their own reasons, wanted to have their own unemployment insurance system. Those reasons are really past, and we should consider federalizing the unemployment insurance system to a greater extent.

So we should take advantage of—let me just summarize—the fact that most Americans participate in Social Security. That does not happen in other countries. They avoid paying a payroll tax in the black market, and take advantage of the very low cost and efficient——

Senator BROWN. Well, but you said ours is more universal, and now you are saying that others—that we avoid it more——

Dr. GHILARDUCCI. That we should celebrate that ours is universal in theory and in fact, where other countries have a social insurance system that a lot of workers avoid by working in the black or gray markets.

So let us take advantage of the fact that everybody pays a Social Security tax, and add in other insurance products.

Senator BROWN. Thank you.

And my last question is for Dr. Fichtner. So, when is the wedding?

Dr. FICHTNER. May 31st, so I have to——

Senator BROWN. You have to get out of here. All right. [Laughter.]

Thank you all. This was a very good discussion. I appreciate the openness and the candor from all of you and the good insight and the public service all of you bring to this. We will have some—and I think I could speak for some others—we will have some written questions. If you could answer them as quickly as possible.

The subcommittee is adjourned.

[Whereupon, at 11:56 a.m., the hearing was concluded.]

APPENDIX

Additional Material Submitted for the Record

Senator Brown Opening Remarks for Finance Subcommittee Hearing
"Strengthening Social Security to Meet the Needs of Tomorrow's Retirees"
Wednesday, May 21, 2014

When Social Security began, it was an untested idea that was met with a great deal of misunderstanding and resistance.

Today, it is woven into the fabric of our country. A few years ago, the idea that we would expand Social Security seemed unlikely. All of the conventional Washington wisdom was that we would have to cut the program.

Today, not only are cuts to Social Security deeply unpopular, but we are now debating how much we need to expand the program.

Today's hearing is to consider whether Social Security is adequate to meet the challenges facing today's workers and to discuss what policies we should consider to expand the program.

Over the last few years, we have fallen into a bad habit of allowing the debate around Social Security to be conducted in the context of the budget.

This is not the correct approach.

First, discussing Social Security in the context of the federal budget is incorrect from an accounting perspective as Social Security has its own dedicated source of funding.

Second and more importantly, we should not be raising Social Security in the context of the federal budget – *instead, Social Security is about family budgets.*

Social Security is social insurance.

Let me repeat that – Social Security is social insurance.

It's a plan that offers working families a modest bundle of insurance products – retirement, life, and disability insurance – at reasonable rates.

For the bottom two quintiles of Americans over 65, Social Security benefits represent 84 percent of retirement income. For the middle quintile – households with an $18,000 maximum benefit – Social Security benefits represent approximately 65 percent of retirement income. Even in the fourth quintile, Social Security represents 44 percent of seniors' retirement income.

Social Security is one of the three legs of what we call the retirement stool. The other two legs of the stool – personal savings and pension plans – have disappeared for the average worker.

Wages have stagnated, leaving folks struggling to make ends meet, let alone put aside for retirement. Defined benefit plans have declined, and only half of workers have access to an employer-sponsored retirement plan.

Social Security is more important than ever.

It lifts 22 million people out of poverty, including 15 million seniors, 9 million women, and 1 million children.

In Ohio, there are 2 million Social Security beneficiaries, and the program keeps more than 650,000 seniors out of poverty.

That is how critical these social insurance programs are for American workers.

This isn't just a moral issue. It's an economic issue.

Last year, Social Security benefits fueled $1.4 trillion in economic output, supported more than 9 million jobs, and generated $222 billion in payroll tax revenue.

Let's keep in mind that Social Security's benefits are modest. Most checks are a little more than $300 a week.

At the same time, the program is highly efficient, with less than 1 percent of revenue being used for administration. Bipartisan legislation in 1983 and 1993 placed the program's finances on a predictable path. This tradition of common-sense, bipartisan action should continue as we reallocate the disability trust fund – a simple process that Congress has done in bipartisan manner 11 times since 1957.

Reallocation is not controversial. Twenty years ago, the Social Security trustees predicted that we would need to reallocate the trust fund in 2016 – and we will.

Simple reallocation can be done without increasing taxes or decreasing benefits, and it will result in the program being solvent for the next two decades.

We all know the financing options that will make Social Security solvent for decades to come and fund the kinds of expansions we all know are necessary to confront the retirement crisis.

We have only to find the courage to act.

Social Security is under duress today despite its inherent strength.

Current law has baked a series of cuts into Social Security that will slowly erode retirement benefits by 25 percent over the next few decades. But raising the retirement age, increasing taxes, and delaying cost-of-living adjustments or COLAs are blunt instruments that harm low-income workers.

Americans who work construction or who work all day on their feet in diners or in steel mills cannot work until they are 70, and they cannot retire with dignity without the savings to do so.

Americans who have worked hard all their lives are seeing their prescription bills increase. They cannot afford a tax increase or an unrealistic cost-of-living adjustment.

That's why we must consider proposals to expand Social Security to meet the increased needs of the next generation of retirees.

These proposals include a bill Chairman Harkin and I have introduced to change the benefit formula, particularly for low-income workers, and update the COLA to reflect the true cost of living for seniors.

We will also discuss proposals to increase survivors' benefits. We know that for so many low-income families, Social Security is the only life insurance available.

We will also discuss proposals to increase the benefits for our most vulnerable populations. We can do this by updating the SSI program, which has not been updated or indexed since its inception in 1972.

We will examine proposals to provide caregiver credits to workers who support children or parents.

When children must leave the workforce to care for their aging parents, that represents real work. Those caregivers also deserve a modest, but dignified retirement.

Finally, we will talk about ways to use Social Security's proven track record to help working families by expanding the program to provide paid family leave and help the children of deceased beneficiaries attend college.

I will stop there and yield to my fellow Eagle Scout, Ranking Member Toomey.

He has been a gracious partner in putting together these hearings, and I look forward to working with him on these issues.

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TESTIMONY

ADDRESSING THE REAL 'RETIREMENT CRISIS' THROUGH SUSTAINABLE SOCIAL SECURITY REFORM

BY JASON J. FICHTNER, PhD

United States Senate
Committee on Finance

Subcommittee on Social Security, Pensions, and Family Policy

Hearing on "Strengthening Social Security to Meet the Needs of Tomorrow's Retirees"

May 21, 2014

Good morning, Chairman Brown, Ranking Member Toomey, and Members of the Subcommittee. Thank you for inviting me to testify today.

My name is Jason Fichtner, and I'm a senior research fellow at the Mercatus Center at George Mason University, where I research fiscal and economic issues, including Social Security. I am also an affiliated professor at Georgetown University, Johns Hopkins University, and Virginia Tech, where I teach courses in economics and public policy. Previously I served in several positions at the Social Security Administration, including Deputy Commissioner (Acting) and Chief Economist, and in those capacities one of my responsibilities was to lead the agency's financial literacy efforts. All opinions I express today are my own and do not necessarily reflect the views of my employers.

I'd like to begin by thanking Chairman Brown and Senator Toomey for the leadership you provide this committee to ensure that important public policy issues involving Social Security and retirement security get the attention and debate they deserve and also to ensure that ideas and viewpoints from all sides are aired in a collegial and respectful manner. It is truly a privilege for me to be here testifying before you today.

My testimony focuses on two key issues: first, the extent to which we're actually facing a so-called "retirement crisis," and second, how the current structure of the nation's largest retirement program, Social Security, is contributing to the problem by providing *dis*incentives to work and save.

From this discussion, I hope to leave you with the following takeaways:

1. Painting all Americans with the broad brush of a "retirement crisis" creates an incomplete picture of the true financial landscape faced by America's future retirees.

2. The narrative of the "retirement crisis" leads us to look toward greater dependence on—and the expansion of—government programs such as Social Security, which are already facing severe financial problems.

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The ideas presented in this document do not represent official positions of the Mercatus Center or George Mason University.

3. And Social Security reforms should not exacerbate existing problems—such as problematic incentives. Reforms should focus on encouraging increased US savings, labor-force participation, and economic growth.

PERCEPTION OF A RETIREMENT CRISIS

The national newspapers are full of stories claiming that Americans are woefully unprepared for retirement. A recent top story on the Wall Street Journal's MarketWatch was titled "Our Next Big Crisis Will Be a Retirement Crisis."[1] An often-cited index of retirement preparedness compiled by the Center for Retirement Research at Boston College claims that "53 percent of households are 'at risk' of not having enough to maintain their living standards in retirement."[2] Referencing a similar study by Putman Investments, financial reporter Robert Powell writes, "Americans are on track to replace just 61% of their current income once they reach retirement."[3] Powell further notes that the picture looks even gloomier for those without an employer-sponsored retirement plan, who are "projected to be able to replace just 42% of their working income once they retire, even with Social Security factored in."[4]

Stories about the current slow economic recovery and the 2008 financial crisis only further enhance the perception that we are facing a "retirement crisis." This perception is partially based on the economic meltdown that began in 2008 and resulted in a great and unanticipated loss of wealth for millions of Americans. The US stock market, as measured by the broad S&P 500 index, fell nearly 57 percent from a peak on October 10, 2007, to a bottom on March 9, 2009.[5] Housing prices plummeted and unemployment rose quickly to double digits. Survey research suggests financial wealth for the median household declined by 15 percent as a result of the 2008 financial crisis.[6]

While the broad stock market has recovered much of its losses and reached new highs, and housing prices have started to recover, unemployment is still too high. Unemployment rates for workers between the ages of 55 and 64 averaged 7 percent for the years 2009 and 2010 compared to 3 percent for the preceding four-year period, from 2005 to 2008.[7] As of April 2014, the unemployment rate for workers ages 55 to 64 was 4.4 percent—still far above the 3 percent average between 2005 and 2008.[8]

But do these statistics truly equate to a looming "retirement crisis"? Syl Schieber and Andrew Biggs wrote in January 2014 that "...the story about the declining income prospects of retirees is not true."[9] Schieber and Biggs base their argument on the fact that the data most often cited to show there is a crisis is compiled by the Social Security Administration based of the Current Population Survey (CPS) from the US Census Bureau. The CPS data does not accurately reflect the total amount of income in retirement derived by individual retirement accounts. When instead Schieber and Biggs looked at tax return data from the Internal Revenue Service, the reported income was much higher: "The CPS suggests that in 2008 households receiving Social Security benefits collected $222 billion

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1. Brett Arends, "Our Next Big Crisis Will Be a Retirement Crisis," MarketWatch, March 3, 2014, http://www.marketwatch.com/story/our-next-big-crisis-will-be-a-retirement-crisis-2014-03-03. Accessed May 11, 2014.
2. Center for Retirement Research at Boston College, National Retirement Risk Index, http://crr.bc.edu/special-projects/national-retirement-risk-index/. Accessed May 12, 2014.
3. Robert Powell, "Americans Fall Short on Retirement Income," MarketWatch, May 2, 2014, http://www.marketwatch.com/story/americans-fall-short-on-retirement-income-2014-05-02. Accessed May 11, 2014.
4. Ibid.
5. The data are available from Yahoo Finance. S&P 500 index value at market close on October 10, 2007, was 1562.47. Index value at close on March 9, 2009, was 676.53. The National Bureau of Economic Research, the arbiter of the start and end dates of a recession, determined that the recession that began in December 2007 ended in June 2009, roughly coinciding with the peak and trough dates of the S&P 500 index.
6. Michael D. Hurd and Susann Rohwedder, "The Effects of the Economic Crisis on the Older Population," MRRC Working Paper No. 2010-231, Michigan Retirement Research Center, Ann Arbor, MI, 2010.
7. US Bureau of Labor Statistics, Labor Force Statistics from the Current Population Survey, www.bls.gov/data/#unemployment.
8. US Bureau of Labor Statistics, "Employment Status of the Civilian Noninstitutional Population by Age, Sex, and Race," Labor Force Statistics from the Current Population Survey, http://www.bls.gov/web/empsit/cpseea13.htm. Accessed May 11, 2014.
9. Sylvester Schieber and Andrew Biggs, "Retirees Aren't Headed for the Poor House," *Wall Street Journal*, January 23, 2014.

in pensions or annuity income. But federal tax filings for 2008 show that these same households received $457 billion of pension or annuity income."[10]

Additionally, in order to have a financially secure retirement, many financial planners suggest a replacement rate of 70 percent.[11] The "replacement rate" is how much of your pre-retirement income a person will need in retirement. Social Security was designed to replace about 40 percent of a person's pre-retirement income, with higher replacement rates for lower-income workers,[12] the remaining amount to be covered by an employer pension and/or personal retirement savings. For example, a person who earns $50,000 in each of the final five years leading up to retirement should plan to have enough retirement savings to generate $35,000 a year in income ($50,000 x 0.70). The 70 percent figure includes income received from Social Security. This is just a general rule of thumb, and everybody's retirement needs are different. For example, some find they need less in retirement as their consumption tends to decline and their house may be paid off. It is worth noting that the proper way to measure replacement rates is currently debated by scholars[13]—should we look at average lifetime earnings, wage-adjusted earnings, or earnings in the final year before retirement?[14]—and so on.

Please do not misunderstand me. I'm not arguing that everyone has adequately saved for retirement. Nor am I arguing that policymakers shouldn't focus their efforts on public policy options that will help Americans save for their retirement. But I do want to stress that painting all Americans with the broad brush of a "retirement crisis" creates an incomplete picture of the true financial landscape faced by America's future retirees. Further, I'm concerned that the narrative being told of a "retirement crisis" is leading us to look toward greater dependence on—and even the expansion of—existing government programs, many of which, Social Security included, are already facing severe financial problems. *This is simply not a sustainable plan.* We must turn instead toward policy options that will encourage individuals to work, save, and invest so that they can build their own financially secure retirement.

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10. Ibid.

11. Michelle Singletary, "The Color of Money: Calculating the 'Replacement Rate,'" *Washington Post*, December 31, 2013, http://www.washingtonpost.com/business/the-color-of-money-calculating-the-replacement-rate/2013/12/31/a1d7e59e-725a-11e3-8def-a33011492df2_story.html.

12. Depending on the measure of replacement rate used, Social Security benefits may provide a higher replacement rate than 40 percent. As noted by Biggs and Springstead, ". . . measuring replacement rates is far from straightforward, and different replacement rate measures can result in widely different indicators of retirement income adequacy." Further, ". . . Social Security pays higher average replacement rates to those with lower lifetime earnings, although there is significant dispersion of replacement rates within groups with similar lifetime earnings." Andrew Biggs and Glenn Springstead, "Alternative Measures of Replacement Rates for Social Security Benefits and Retirement Income," US Social Security Administration, *Social Security Bulletin* 68:2 (2008).

13. See, for example, Andrew Biggs and Glenn Springstead, "Alternative Measures of Replacement Rates for Social Security Benefits and Retirement Income," US Social Security Administration, *Social Security Bulletin* 68:2 (2008) and Charles Blahous, "Understanding Social Security Benefit Adequacy: Myths and Realities of Social Security Replacement Rates," Mercatus Research, Mercatus Center at George Mason University, November 15, 2012.

14. According to Sylvester Schieber, the former chairman of the Social Security Advisory Board, ". . . the earnings replacement rates published in the annual *Trustees Reports* of the Old-Age and Survivors and Disability Insurance (OASDI) programs use a definition of preretirement income that is inconsistent with the definitions used by most plan designers and by many academic and policy analysts. Social Security income replacement rates are extremely important because the program's benefits play such a significant role in the retirement income portfolio of workers and retirees. As a result, confusion about the role that Social Security plays in retirement income adequacy has the potential to be misleading in the larger picture of retirees' income adequacy outcomes." Further, "the potential confusion caused by Social Security's current measure could be cleared up if future annual reports would include an alternative measure (or measures) of program replacement rates based on more conventional estimates of preretirement earnings. This would put readers, researchers and policy analysts on notice that alternative definitions of preretirement earnings are important in estimating replacement rates and allow them to tap a more conventional replacement rate measure when the use the estimates directly from the annual *Trustees Reports*." Sylvester Schieber and Gaobo Pang, "Understanding Social Security's Income Replacement Measures," working paper, Social Science Research Network, April 30, 2014, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2433181.

REFORMS FOR A FINANCIALLY SECURE RETIREMENT

It is important that any reforms remove the negative effects on labor-force participation, improve work incentives, and promote individual saving.

As I have discussed in a previous Congressional testimony (attachment),[15] possible reforms include:

- basing future cost-of-living (COLA) increases on the chained CPI,
- gradually raising the early and full retirement ages,
- increasing the delayed retirement credit,
- adjusting the benefit formula,
- constraining nonworking spousal benefits for high earners,
- providing payroll tax relief to seniors,
- increasing access to private retirement accounts, and
- increasing financial literacy.

CONCLUSION

Social Security faces real and increasingly urgent financial challenges. Reform is not only the wise thing to do, it is critical to ensure that Social Security remains solvent and fiscally sustainable and can continue to provide retirement security for generations to come.

Social Security reform must not only address the program's fiscal solvency issues but also remove the disincentives to working later in life. This means reforms must focus on reining in the growth of program costs, encouraging personal saving and investment, and rewarding those in middle and early retirement age who make the decision to extend their working careers.

Finally, Social Security reform must begin immediately. The Social Security trust fund for the retirement portion of the program is projected to become insolvent in 2035, while the disability trust fund is projected to become insolvent in 2016, just 2 short years away. We can reform this critical program, and we can do it in a way that will improve the financial security of all future Americans in retirement.

Thank you again for your time and this opportunity to testify today. I look forward to your questions.

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15. Jason J. Fichtner, "Reforming Social Security to Better Promote Retirement Security," Testimony before the House Committee on Ways and Means, May 23, 2013, http://mercatus.org/publication/reforming-social-security-better-promote-retirement-security.

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TESTIMONY

REFORMING SOCIAL SECURITY TO BETTER PROMOTE RETIREMENT SECURITY

JASON J. FICHTNER, PHD

United States House of Representatives
Committee on Ways and Means
Subcommittee on Social Security

Hearing on "The President's and Other Bipartisan Entitlement Reform Proposals"

May 23, 2013

Good morning, Chairman Johnson, Ranking Member Becerra, and Members of the Committee. Thank you for inviting me to testify today.

My name is Jason Fichtner, and I'm a senior research fellow at the Mercatus Center at George Mason University where I research fiscal and budgetary issues, including Social Security. I am also an adjunct professor at Georgetown University, Johns Hopkins University, and Virginia Tech, where I teach courses in economics and public policy. All opinions I express today are my own and do not necessarily reflect the views of my employers.

I'd like to begin by thanking Chairman Johnson and Congressman Becerra for the leadership you provide this committee in ensuring that important public policy issues involving Social Security and retirement security get the attention and debate they deserve, and also for ensuring that ideas and viewpoints from all sides are aired in a collegial and respectful manner. It is truly a privilege for me to be here testifying before you today.

My testimony focuses on the Social Security program's incentives—specifically, how the current structure provides disincentives to work and save. I will also discuss how Social Security reform, if done correctly, can increase US savings, labor force participation, economic growth, and federal revenues.

THE ECONOMY'S EFFECTS ON WHEN PEOPLE CLAIM SOCIAL SECURITY BENEFITS

The financial crisis that began in 2008 resulted in a great and unanticipated loss of wealth for millions of Americans. The US stock market, as measured by the broad S&P 500 index, fell nearly 57 percent from a peak on October 10, 2007, to a bottom on March 9, 2009.[1] Housing prices plummeted and unemployment rose quickly to double digits. Survey research suggests financial wealth declined by 15 percent for the median household as a result of the 2008 financial crisis.[2] General confidence in the financial system was greatly weakened.

The widespread economic crisis affected a range of ages and income levels. According to data from the Health and Retirement Study (HRS),[3] about 28 percent of surveyed households reported that they had been affected "a

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lot" by the financial crisis, 46 percent responded they had been affected "a little," and only 26 percent reported not having been affected.[4]

Though the broad stock market has recovered much of its losses and reached new highs, and housing prices have started to recover, unemployment is still too high. Unemployment rates for workers ages 55–64 averaged 7 percent for the years 2009–10 compared to 3 percent for the period 2005–8.[5] As of April 2013, the unemployment rate for workers ages 55–64 was 5.1 percent—still far above the 3 percent average between 2005 and 2008.[6]

A sudden and unplanned drop in wealth and income can have significant effects on retirement behavior. Research I've done with coauthors John Phillips and Barbara Smith finds that more people will elect to begin taking Social Security retirement benefits as soon as eligible, due to financial shocks, increases in unemployment because of the global financial crisis,[7] and an arrested economic recovery.[8]

A study by Michael Hurd and Susann Rohwedder after the 2008 crisis finds that 3.5 percent more individuals expected to work past the age of 62 than previously, while an additional 4.3 percent planned to work past the age of 65.[9] A financial shock, such as steep drops in the value of stock prices, investment portfolios, and housing assets might cause a delay in people's retirement plans,[10] with workers remaining in the workforce longer than originally planned to rebuild retirement savings.[11] Those near or post-retirement are more limited in their ability to attain or maintain a secure retirement. For current retirees, sudden declines in wealth from housing assets and financial portfolios might force immediate changes in consumption.

The loss of a job has particularly pronounced effects on workers above the age of 55 and on the decision to retire. According to a special study in 2010 from the US Bureau of Labor Statistics,[12] older workers who lose their jobs are likely to have longer durations of unemployment than younger workers. A Congressional Research Service study finds that older workers who are unemployed have a higher incidence of withdrawing from the labor market than younger workers.[13] When they do retire, they replace earnings with available sources of income, such as pensions and Social Security benefits. Workers who retire early may experience lower lifetime benefits from Social Security, and their removal from the workforce slows economic growth.

Though the decision to start receiving Social Security benefits can be concurrent with retirement, electing to receive benefits is not necessarily a predictor of leaving the workforce.[14] In fact, the decision whether to stop working can be completely independent from the decision whether to begin collecting Social Security benefits. For example, a worker might choose to stop working but delay receipt of Social Security benefits to take advantage of higher monthly benefit amounts that accrue the later one waits to claim (up to age 70). Or a worker might decide to elect retirement benefits as early as age 62, receiving a permanently reduced monthly benefit,[15] yet continue to work full- or part-time for continued income support.[16] In some cases, a worker might opt to select Social Security benefits and then return to work.[17]

Researchers have long recognized the role Social Security benefits play in a secure retirement.[18] Social Security retirement benefits provide income security for millions of Americans, with 65 percent of all aged recipients[19] relying on Social Security for 50 percent or more of their income, and 36 percent relying on Social Security for 90 percent or more of their income.[20] Because low-income households use Social Security benefits for a larger portion of annual income, the financial crisis has affected these retirees less.[21] As a result, the structure of Social Security has its most significant economic and behavioral effects on the middle class.

NEGATIVE EFFECTS ON LABOR FORCE PARTICIPATION

Most analyses of Social Security have concluded that its current design offers substantially negative incentives for work, especially for younger seniors and for secondary household earners. Research by Gayle Reznik, David Weaver, and Andrew Biggs has found that Social Security's return on payroll tax contributions by those aged 62–65 is −49.5 percent,[22] meaning that the program literally pays back just pennies in additional benefits for each additional dollar contributed. Barbara Butrica and her coauthors have found that the broader array of federal laws strongly inhibits continued work by seniors, with disincentives growing stronger as they age: "The implicit tax rate on work increases rapidly with age, rising for our representative worker from 14 percent at age 55 to 50 percent at age 70."[23]

Notably, labor force participation did not immediately decline for those younger than 65 (and thus originally ineligible for Social Security benefits) until Social Security's early eligibility age (EEA) of 62 was established.[24] After the creation of the EEA, labor-force participation by males aged 55–64 also began to trend downward, from 87.3 percent in 1960 to 67.7 percent by 1990. As the Bureau of Labor Statistics notes, "Labor force participation decreases started in the 1960s for those 55 to 64. Since this time, some of the 20-percentage points decrease for men in this age group has to be attributed to the availability of Social Security benefits to men 62 years of age."[25] The Bureau of Labor Statistics report also notes the new availability of Social Security's disability benefits and suggests that they further dampened middle-aged labor-force participation.

How Does Social Security Penalize Work?

The basic Social Security benefit formula is itself designed to impose net incremental income losses on those who extend their working careers.[26] Previous studies by Charles Blahous;[27] Gopi Shah Goda, John B. Shoven, and Sita Nataraj Slavov;[28] and others have explained how returns on contributions generally diminish the longer one works and why they become even more sharply negative once a worker has contributed for 35 years.

The primary reasons for the work disincentives are the facts that the Social Security benefit formula is progressive, while also based on a worker's top 35 years of earnings on average. Thus, the longer one works, the more "zero earnings years" in one's wage history are replaced with positive earnings years and the more one's "average earnings" rise (so that one is gradually considered a relatively higher-wage earner), and thus the worse one's returns under the program's progressive benefit formula.[29]

This worsening becomes particularly pronounced after 35 years of earnings,[30] when the best a worker can hope for is to replace a previous year in the highest 35 years of one's wage history with a higher earnings year. That is to say, after 35 years of work, one's benefit can only rise in proportion to the differential between two previous earnings years, despite paying a full additional year of payroll taxes. Indeed, someone who takes a part-time "transition job" on the way to full retirement may well pay a full year's worth of additional taxes while receiving no additional benefit credits whatsoever. This embodies a substantial work disincentive at precisely the time when a worker is likely to make a retirement decision.

Penalties against Seniors and 55–65-Year-Olds

Though this sustained trend toward early retirement has bottomed out and begun to reverse somewhat in recent years, Social Security on balance clearly remains a substantial barrier to labor participation by Americans in their late middle age. For example, seniors who continue to work after claiming Social Security benefits at 62 (but before normal retirement age [NRA] of 66) are subject to an earnings limitation under which they are required to temporarily give up as much as $1 in benefits for every $2 earned above a $15,120 threshold.[31] This rule is but one of the program's facets that nudge individuals into early retirement.

Social Security's EEA of 62 is, in fact, the most common age of benefit-claiming.[32] Over 70 percent of beneficiaries take advantage of the opportunity to claim Social Security retirement benefits before NRA, despite receiving lower monthly benefits by doing so.[33] Not long ago, Social Security Administration (SSA) field offices often encouraged early retirement under the mistaken belief that it leaves beneficiaries better off. Early retirement is only certain to make beneficiaries better off in the short run, however. The reduction in monthly benefits that accompanies early claims also results in net lifetime benefit reductions for those who live to especially advanced ages—often a time in life when beneficiaries are most likely to rely on Social Security benefits to pay their expenses. Fortunately, the SSA has more recently adopted policies recognizing that individual circumstances must be carefully considered when determining one's optimal age for claiming benefits.[34]

Penalties for Two-Earner Couples

Social Security specifically provides a disincentive to taxpaying work by more than one earner per household. Incremental returns on taxes paid by women have been estimated at −32.0 percent relative to what they would

receive by staying out of the paid workforce altogether and instead often collecting the nonworking spouse benefit.[35] As a general rule, Social Security aggressively redistributes income from two-earner married couples to one-earner married couples, thus penalizing a household decision to have both spouses work and contribute payroll taxes. For example, a medium-wage two-earner couple, both born in 1955, can expect to receive back only 80 cents from Social Security on each dollar contributed (in present value), whereas a one-earner couple can expect to receive $1.39.[36] Today 61 percent of married women participate in the labor force, compared to only 32 percent in 1960—and there are more women than men in the modern-day workplace.[37] Much of the original welfare system was designed to support single-earner families.[38] As a result of changing demography, Social Security needs to reflect the evolving workplace and not penalize two-earner couples.

One reason for this income redistribution and these negative labor participation incentives is the structure of Social Security's nonworking spouse benefit. Individuals without any history of paid employment can be entitled to receive a benefit equal to 50 percent of their spouse's earned benefit. Consequently, an individual who is married to a high-wage earner may receive a benefit well exceeding what another individual might earn based on an entire working career of payroll tax contributions.

Despite the complexities involved in determining one's net effective tax rate on Social Security–covered work, there is evidence that individuals and two-earner couples do respond rationally to these disincentives. As Jeffrey B. Liebman, Erzo F. P. Luttner, and David G. Seif point out in a 2008 study, "Our estimates conclusively reject the notion that labor supply is completely unresponsive to the incentives generated by the Social Security benefit rules. We find reasonably robust and statistically significant evidence that individuals are more likely to retire when the effective marginal Social Security tax is high."[39] For most seniors, these effective marginal tax rates are indeed enormously high.

These various features of Social Security—from the technical details of its benefit formula, to the earnings limitation, to the benefit eligibility at age 62, to the nonworking spouse benefit, to others—all act as a drag on labor-force participation and thus interfere with the goal of maximizing future economic growth.

THE FISCAL IMPORTANCE OF LABOR-FORCE PARTICIPATION

The financial unsustainability of current federal entitlement programs is substantially attributable to insufficient projected growth in the US labor force. This conclusion can be substantiated by some simple math. Social Security's initial benefit formula, for example, increases along with growth in the national Average Wage Index.[40] Because program payroll tax revenues also automatically grow with national wages, this benefit formula would be financially sustainable within a stable tax rate if the worker-to-beneficiary ratio never declined—or in other words, if gains in longevity and health were always matched by proportional increases in the duration of workers' taxpaying careers.[41] This proportionality, however, is not being maintained. Worker–beneficiary ratios are projected to become much more unfavorable going forward.

Though press attention rightly focuses on how the Baby Boomers' Social Security and Medicare benefit claims will increase federal spending, the other side of the coin is the corresponding reduction in labor force growth rates as the Boomers cease working. Whereas from 1963 through 1990 inclusive annual labor-force growth rates never once dropped below 1.2 percent despite periodic recessions, from 2019 onward labor force growth rates are projected never to exceed even half that rate (0.6 percent).[42] Thus, to the extent that Baby Boomers and subsequent generations perceive greater rewards for extending their working lives, the picture of our national economic future will brighten enormously.

It bears emphasis that workforce participation trends among those in their 60s are not driven primarily by issues of physical incapacity. Labor-force participation among males over 65 was much higher in the mid-20th century than it is now despite substantial gains in national health and longevity since then. Incentives have played a much greater role. Beyond the fact that it is generally more attractive to enjoy additional years of leisure rather than to continue work, our federal entitlement policies have made the decision to retire virtually irresistible financially as well. Given these incentives, it is unsurprising that our future economic growth outlook is depressed by current projections for labor-force participation, relative to what would be the case if more of our national gains in longevity and health were converted into longer periods of taxpaying work.

The economic benefits of longer working careers well exceed, however, what is shown in federal scorekeepers' analyses of program finances. Repeal of the Social Security earnings limitation, for example, is scored under current SSA methodology as actuarially neutral, although it would almost certainly incentivize longer working careers, both generating additional government tax revenue and benefiting the economy as a whole. Similarly, proposals to raise Social Security's EEA of 62 are not scored by the Social Security actuaries as producing direct financial gains for the program, though the change would better incentivize taxpaying work by those in their early 60s.

A recent Congressional Budget Office (CBO) analysis of raising the EEA acknowledges this effect conceptually but does not attempt to quantify it: "This option also would probably lead workers to remain employed longer, which would increase the size of the workforce and boost federal revenues from income and payroll taxes. Moreover, the additional work would result in higher future Social Security benefits, although the increase in benefits would be smaller than the increase in revenues." But "the 10-year estimates for this option do not include those two effects."[43] Other CBO analyses, including those of the Diamond-Orszag and the Bush Commission's proposals, quantify some potential advantages of reforming Social Security benefits for promoting economic growth. CBO found that the Bush Commission plan to constrain the growth of benefits beyond price inflation would increase national GNP relative to the budget baseline, whereas the Diamond-Orszag proposal to raise Social Security taxes would reduce it. These findings in turn reflected analyses that the Bush Commission proposal "could cause some people to work longer or harder,"[44] whereas under the Diamond-Orszag proposal, "households would choose more leisure."[45]

Extended workforce participation would pay dividends for individual seniors as well as for the economy as a whole. As Butrica and her coauthors noted in 2004, "Working longer increases the net output and productivity of the economy, generates additional payroll and income tax revenue, and reduces the number of years that individuals receive retirement benefits. . . . [P]eople could increase their annual consumption at older ages by more than 25 percent simply by retiring at age 67 instead of age 62. The increased tax revenues generated by this work could be used to support a wide range of government services, including public support for the aged."[46]

For these and many other reasons, Social Security reform as well as broader entitlement reform should be undertaken with an eye toward rewarding those in late middle age who decide to extend their working careers.

SOCIAL SECURITY REFORMS TO IMPROVE WORK INCENTIVES

Bowles-Simpson and the Bipartisan Policy Center Plans

The impact of Bowles-Simpson and the Social Security reforms of the Bipartisan Policy Center (BPC) on work incentives vary depending on the specific provision examined. While some reforms encourage greater participation in economic activity, others limit the desirability of work and could incentivize even earlier retirement. Some proposals would encourage significant behavioral shifts while others would encourage only marginal changes.

Both plans include the following policy recommendations that would encourage greater labor force participation: adjusting the cost-of-living adjustment (COLA) to be indexed according to a Chained-CPI-U, to account for substitution effects as consumers change what goods they purchase in response to changes in prices; reducing the growth of benefits for the highest-earning beneficiaries; and indexing the benefit formula for longevity. Of these three reforms, indexing the COLA to Chained-CPI-U would most increase the desirability of individual saving. President Obama has also proposed indexing the COLA to the Chained-CPI-U in his FY 2014 budget.

The proposed CPI-U price index accounts for living expenses for around 87 percent of the US population. It is a measure of inflation facing all urban consumers. The current CPI-W index, however, measures the higher rate of inflation experienced by all urban workers, roughly 32 percent of the population.[47] Because the W index represents a subset of the U population, many Social Security recipients experience inflation-adjusted wages that exceed their actual cost-of-living increases. Adjusted wages in excess of inflation incentivizes less individual saving and lower labor-force participation in exchange for greater reliance on Social Security.

The two other benefit reductions considered by the Bowles-Simpson and BPC plans are designed to make the benefit structure more progressive and to slow the growth of benefits for higher-income workers. The first would marginally reduce the growth of benefits for approximately the top 25 percent of beneficiaries. The proposal by BPC would slowly reduce the top bend point in the primary insurance amount (PIA) formula applied to a person's average indexed monthly earnings from 15 percent to 10 percent over a 30-year period.[48] For someone eligible for benefits in 2013, this percentage would apply to additional monthly covered earnings in excess of $4,768. The Bowles-Simpson plan would also adopt a more progressive benefit formula that slows the growth of benefits for higher-income earners by expanding the amount of earnings at the bottom end that are covered by the 90 percent replacement rate and would subject higher-income earners to a new and lower top-end replacement rate of 5 percent. While this reform should encourage the top 25 percent of beneficiaries to work longer and save more, a more progressive benefit formula that gives a higher benefit amount to lower-income workers could have the opposite effect and would not encourage additional saving or longer labor-force participation.

The second benefit change considered by both Bowles-Simpson and BPC is to adjust benefits for expected increases in longevity. As Americans live longer, the financial commitment of Social Security increases as well. Lifetime benefits for Social Security recipients are greater than ever and will continue to increase. BPC would reduce benefits beginning in 2023 (after the full retirement age increases to 67 under current law) by 0.3 percent each year in order to offset part of the additional costs of estimated longevity increases. Bowles-Simpson would gradually increase both the early eligibility age and normal retirement age to account for increases in longevity. Adjusting Social Security to reflect increases in longevity would encourage greater labor-force participation and saving.

The following policy recommendations would penalize the decision to work and encourage earlier retirement: raising the amount of income subject to payroll taxes and increasing the special minimum benefit. Raising the amount of income subject to payroll taxes could have negative implications for investment and saving levels. I won't elaborate in detail in my testimony on the negative economic effects of raising payroll taxes, as previous witnesses have testified before this committee extensively on the topic.[49] But, in brief, raising Social Security payroll taxes would generally mean that people would work less, because the financial return from work has been decreased; save less, because they now have less after-tax income with which to save; and retire early, because the replacement rate of Social Security benefits will rise.[50]

The final policy recommendation from the BPC and Bowles-Simpson is to increase the special minimum benefit and to provide a "bump up" in benefits for beneficiaries in their 80s. The special minimum benefit was enacted in 1972 to provide minimum financial protection for low-income workers.[51] However, the current minimum benefit is adjusted for changes in prices, not wages. As wages have grown faster than prices, the PIA for most low-wage workers is higher than the special minimum PIA. The BPC plan would propose a special minimum benefit set at 133 percent of the poverty level for retirees with at least 30 years of covered work. The Bowles-Simpson plan would set the special minimum benefit at no less than 125 percent of the poverty level in 2017 and index it to wage growth thereafter. The proposed "bump up" is a small boost in income that retirees would receive between the ages of 81 and 85 (BPC plan), and for those on benefits 20 years after the earliest eligibility age (Bowles-Simpson), as saving levels tend to be significantly reduced once beneficiaries reach this age range.

The goal of the special minimum benefit and "bump up" for those in their 80s should be to reach beneficiaries who would otherwise be unable to provide for themselves rather than to provide a general welfare expansion for all retirees. Social Security's benefit structure already discourages labor-force participation. So, while we should definitely ensure that our society's most vulnerable members are protected against poverty, an expansion of the special minimum benefit should reach only those most in need in order to avoid having further negative impacts on the labor-force participation rate.

Raising the Early Eligibility Age

With age 62 now the most popular age to claim benefits, raising the EEA would necessarily delay many claims and would likely correlate with continued employment.[52] Research has estimated that raising the EEA to 65 would increase long-run GDP by 3–4 percent.[53]

Several key points should be kept in mind with regard to raising the earliest eligibility age. First, an EEA increase of three years, for example, would merely bring the age of earliest eligibility to what it was at the program's inception; it would not begin to adjust for the substantial health and longevity gains since. Period life expectancy at birth has grown by more than 14 years since 1940, while life expectancy at 65 has grown by more than six years.[54]

Second, raising the EEA to bring it closer to the NRA would likely reduce poverty among seniors, as they would be subject to a smaller early retirement penalty. As previously noted, annual benefits under Social Security law are adjusted downward from full benefit levels in proportion to how early one claims before reaching the NRA. This keeps expected lifetime benefits constant, regardless of the age of claim; some of the risk of old-age poverty resides with seniors who retire early, have "too low" an annual benefit, and then outlive their other savings.

Increase the Delayed Retirement Credit

Another positive work incentive could be created by increasing the program's actuarial penalty for early retirement as well as its delayed retirement credit (DRC). The current actuarial penalty for early retirement is a 25 percent reduction in annual benefits for those who retire at 62, four years before the current NRA of 66, or about a 6 percent reduction for each year.

On the other hand, the delayed retirement credit is an 8 percent increase in annual benefits for each year (up to age 70) claims are delayed beyond the NRA. For someone delaying claiming benefits until age 70, this credit amounts to a 32 percent increase in the monthly benefit.[55] These current-law adjustments hold expected lifetime benefits constant for a typical retiree, and thus do not account for the value of additional payroll taxes likely contributed if an individual delays claiming benefits and continues working. Increasing these adjustments may better reflect the value of additional payroll taxes contributed by working seniors.

Offering the DRC as a lump-sum option could potentially provide an additional incentive to continue working, without adding a financial cost to the system. The current DRC offers an increase in one's monthly Social Security benefit proportional to the time over which the benefit claim is delayed. However, only a minority (between 5 and 6 percent in 2011) take advantage of this option.[56] It is also worth noting that more than 70 percent of those claiming retirement benefits in 2011 did so before their normal retirement age, thus receiving reduced monthly benefits.[57] An option potentially more attractive to workers would be to allow an individual to receive the entire DRC as a lump sum when claimed, while also receiving the basic monthly benefit as it would have been calculated at NRA. This option could potentially allow claimants to receive a lump sum of tens of thousands dollars on the date of their delayed claim. Recent research by Jingjing Chai and his coauthors confirmed that offering a lump-sum option could boost the average retirement age by 1.5–2 years.[58]

The precise amount of a lump-sum DRC could be calculated to be the actuarial equivalent of the standard monthly DRC, thus creating no additional system costs but potentially spurring longer taxpaying work. But even if the lump sum were designed to be slightly smaller in present value than the DRC would have provided as a monthly benefit stream—thus producing a net improvement in system finances—many individuals might still find the lump-sum option more attractive because they would have immediate access to and control over the funds.

The various reforms mentioned above would likely be useful if enacted separately, but would work best in tandem. Steepening the actuarial penalty for early benefit claims could, despite its other policy benefits, potentially worsen some early claimants' subsequent risk of poverty if enacted as a standalone measure, but would not do so if accompanied by an increase in the EEA. If the NRA is increased while the EEA is held at the current age of 62, a higher minimum benefit could be offered to those in physically challenging jobs unable to work past age 62. However, it is worth noting that SSA only has wage data available and determining which individuals would be allowed a higher minimum benefit at EEA, instead of a regular actuarial

reduction, would be administratively challenging and burdensome to say the least, and may be impossible to administer.

As mentioned earlier in my testimony, both the Bowles-Simpson and BPC plans would offer an increased minimum benefit to protect low-wage workers, as well as a bump-up in the benefit amount for those in their 80s and the long-term disabled. While the Bowles-Simpson plan recommends increasing the early eligibility and normal retirement ages, the plan also recommends that the Social Security Administration be tasked with designing a policy that would allow a hardship exemption for those that cannot physically work past age 62.

Adjust the Benefit Formula

Another potentially important work incentive reform would be to redesign the basic benefit formula so that it operates on each separate year of work rather than on one's career average earnings. As discussed previously, the current formula causes one's returns from Social Security to drop with extended work, as one's career average earnings rise and the system's progressive benefit formula thus delivers lower returns.

An alternative suggested by Charles Blahous, a public trustee for Social Security, would be to calculate benefits by considering every year of one's earnings, rather than only the highest average 35 years of earnings.[59] In addition to greatly improving work incentives for seniors, this reform would have other advantages. For example, the current formula often mistakes intermittent high-wage earners for low-wage earners because their career "average earnings" look the same. This confusion causes problems in the treatment of those who move in and out of Social Security coverage—for example, higher-wage state and local employees and immigrants, whom the formula mistakes for needy low-wage workers—necessitating complex fixes such as the Windfall Elimination Provision (WEP) and the Government Pension Offset (GPO). Such controversial complexities would become unnecessary if Social Security simply accrued proportional benefits with each additional year of taxpaying work, since all intermittent workers would be treated the same, more in the fashion of a traditional private-sector pension.

Constrain Nonworking Spouse Benefits for High Earners

Another work-incentive reform would be to gradually restrain the growth of nonworking spouse benefits associated with higher earners. The nonworking spouse benefit does play a useful role within Social Security by recognizing the value of stay-at-home work and of raising the next generation of wage earners. It is, however, inefficiently designed in that it is both regressive and a significant disincentive to paid employment. A two-earner couple both with low wages, for example, receives lower returns from Social Security than a high-wage one-earner couple,[60] despite the intended progressivity of the basic benefit formula.[61] Additionally, someone married to a high-earning spouse might well receive a higher nonworking spouse benefit than another individual might earn based on a full career of paying payroll taxes on modest annual earnings.

It is not necessary to eliminate the nonworking spouse benefit to address the inequities described above. One option is simply to constrain its growth so that no future nonworking spouse can receive a benefit exceeding the inflation-adjusted value of the benefits that today's low-wage workers receive based on a full career of payroll tax contributions.

Payroll Tax Relief

Others have suggested that payroll tax relief be offered to seniors who extend their working lives.[62] There are policy downsides to this approach. For example, it would reduce much-needed Social Security tax revenues, though it would increase regular income tax revenues. Also, if enacted in the wrong way, eliminating or reducing the payroll tax contributions for seniors could embody age discrimination. That said, the positive effects such a policy could have on labor participation by seniors should not be dismissed. Versions that avoid the age-discrimination pitfall have been put forward by Mark Warshawsky and John Shoven.[63] The basic idea would be to establish a status of being "paid up" under Social Security after a given number of years of contributions (45

in the Warshawsky formulation), after which no further payroll taxes would be collected. Notably, this change would offer a work incentive to individuals on the way to paid-up status, and not only upon reaching a given age.

One policy challenge associated with improving Social Security's work incentives is that doing so will likely shift the distribution of Social Security income somewhat from women (who are more likely to have work interruptions to bear and raise children) to men (who are more likely to have longer working careers). This income shift is indeed a likely effect of enacting work-incentive repairs in isolation, and it is a concern if one wishes to preserve the full amount of income redistribution from men to women that occurs under current-law Social Security. The concern can be addressed, however, by making the basic benefit formula incrementally more progressive at the same time that work incentive improvements are enacted.[64]

There is no way to know for certain how much Americans in late middle age would respond to reforms to render Social Security friendlier to those who extend their working careers. Evidence from Liebman, Luttner, and Seif suggests that there would be a positive labor supply effect and thus a positive effect on federal revenues, retirement income security, and broader economic growth.[65] At a time when America desperately needs the labor productivity of our skilled, healthiest younger seniors to foster economic growth, we would do well to advance a Social Security system that sides with those who provide us with the benefits of their continued work.

Financial Literacy

The Social Security Administration plays a unique role in the financial security of millions of Americans, and in helping people better prepare for retirement. Therefore, both the Bowles-Simpson and BPC plans encourage the SSA to increase financial literacy efforts to inform people about their retirement choices and to increase savings. Specifically, the BPC plan

> directs SSA to revise aggressively its communications and messaging around the retirement choice. The material provided to workers during their careers about the retirement decision must more clearly show the implications of collecting benefits at different ages. It must highlight the permanent financial consequences of this choice, not only for workers, but for spouses and survivors as well. In particular, SSA should remind workers of uncertainties in retirement, such as potential health-care costs and the possibility that they may live for many years after retiring.

Although people are living longer, a significant fraction of workers continues to start receiving Social Security benefits early, though this permanently reduces monthly benefits. Research links financial literacy and saving behavior, indicating that the less financially literate are also less likely to plan for retirement.[66] Better informing people about the full costs of claiming benefits early may lead to more people choosing to delay claiming until the full retirement age, or longer, thus improving labor-force participation among seniors. For example, an innovative study by Jeff Brown, Arie Kapteyn, and Olivia Mitchell uses the American Life Panel to experiment with different ways of framing monthly benefit information. The authors hold constant the factual information presented but vary how the information is presented to highlight the financial gains of delaying or claiming. That study finds that framing information strongly shaped respondents' expected claiming ages.[67]

Promoting financial literacy should be done regardless of any Social Security reform plan, in part because research finds differences between how much people expect to receive in Social Security benefits when they retire and what they actually receive. For example, only 19 percent of workers can correctly identify the age at which they will be eligible for full benefits from Social Security.[68] Further, the 2011 Retirement Confidence Survey (RCS) found that current workers are half as likely to expect Social Security to provide a major share of their income in retirement (33 percent) as current retirees are to say Social Security makes up a major share of their income (68 percent).[69] However, research conducted by the Employee Benefit Research Institute (EBRI) found that 60 percent of those aged 65 or older received at least three-quarters of their income from Social Security in 2009.[70] Additionally, although people are living longer, a significant fraction of workers continues to take Social Security benefits at age 62 even though this permanently reduces monthly benefits for the rest of their lives. Research also links financial literacy and saving behavior, indicating that the less financially literate are also less likely to plan for retirement.[71]

A number of Social Security reforms could be implemented that provide incentives to healthy seniors to continue working. Some of these changes would produce net direct savings for the program, whereas others would benefit individual participants at some expense to program finances. The following often-discussed proposals to raise Social Security eligibility ages would likely have a positive effect on worker output and economic growth.

CONCLUSION

Social Security faces real financial challenges. Dismissing the real and current fiscal challenges facing the Social Security system and kicking the "reform can" further down the road will only increase the severity of the burden associated with reforms when they inevitably must take place.

In order to ensure that Social Security remains solvent and continues to provide retirement security for generations to come, while minimizing the burden on current and future generations, reforms must happen sooner rather than later. The Social Security Trustees

> recommend that lawmakers address the projected trust fund shortfalls in a timely way in order to phase in necessary changes and give workers and beneficiaries time to adjust to them. Implementing changes soon would allow more generations to share in the needed revenue increases or reductions in scheduled benefits. Social Security will play a critical role the lives of 56 million beneficiaries and 159 million covered workers and their families in 2012. With informed discussion, creative thinking, and timely legislative action, Social Security can continue to protect future generations.[72]

These reforms should not only address the program's fiscal solvency issues, but also remove the disincentives to working later in life.

Thank you again for your time and this opportunity to testify today. I look forward to your questions.

ENDNOTES

1. The data are available from Yahoo Finance's Historical Prices calculator, http://finance.yahoo.com/q/hp?s=%5eGSPC+Historical+Prices. S&P 500 index value at market close on October 10, 2007, was 1562.47. Index value at close on March 9, 2009, was 676.53. The National Bureau of Economic Research, the arbiter of the start and end dates of a recession, determined that the recession that began in December 2007 ended in June 2009, roughly coinciding with the peak and trough dates of the S&P 500 index.
2. Michael D. Hurd and Susann Rohwedder, "The Effects of the Economic Crisis on the Older Population" (MRRC Working Paper No. 2010-231, Michigan Retirement Research Center, Ann Arbor, MI, 2010).
3. The Health and Retirement Study is a longitudinal survey of health, retirement, and aging that has been conducted every two years since 1992 and interviews more than 22,000 Americans over the age of 50. For more information on the study, see http://hrsonline.isr.umich.edu.
4. Hurd and Rohwedder, "Effects of the Economic Crisis."
5. US Bureau of Labor Statistics, Labor Force Statistics from the Current Population Survey, accessed May 15, 2012, www.bls.gov/data/#unemployment.
6. US Bureau of Labor Statistics, "Employment Status of the Civilian Noninstitutional Population by Age, Sex, and Race," Labor Force Statistics from the Current Population Survey, accessed May 15, 2012, http://www.bls.gov/web/empsit/cpseea13.htm.
7. Jason Fichtner, John Phillips, and Barbara Smith, "Retirement Behavior and the Global Financial Crisis" (Working Paper 2011-10, Pension Research Council, Philadelphia, PA, November 2012), http://www.pensionresearchcouncil.org/publications/document.php?file=980 or http://www.pensionresearchcouncil.org/publications/0-19-966069-7.php (sign-in only).
8. Congressional Budget Office, "Estimates of Potential GDP and the Related Unemployment Rate," February 5, 2013, http://www.cbo.gov/publication/43903. The spreadsheets span January 1991 to February 2013.
9. What is described here are the expectations of working past either age 62 or age 65. Michael Hurd, Monika Reti, and Susann Rhowedder have found that these retirement expectations are predictive of actual retirement. Hurd, Reti, and Rohwedder, "The Effect of Large Capital

Gains or Losses on Retirement," in *Developments in the Economics of Aging*, ed. David A. Wise (Chicago: University of Chicago Press, 2005).

10. In this context, "retirement plans" refers to peoples' goals, strategies, and behaviors, not to defined-contribution or defined-benefit retirement plans.

11. Gary Bosworth and Gary Burtless, "Recessions, Wealth Destruction, and the Timing of Retirement" (CRR Working Paper No. 2010-22, Center for Retirement Research at Boston College, Chestnut Hill, MA, 2010). The timing of retirement can be affected by more than age, including accumulated savings, the availability of an employer-provided pension, the willingness or ability to continue working part-time in retirement, personal health, access to health coverage, and general economic conditions.

12. Emy Sok, "Record Unemployment among Older Workers Does Not Keep Them Out of the Job Market," US Bureau of Labor Statistics, Issues in Labor Statistics, Summary 10-04, March 2010, www.bls.gov/opub/ils//summary_10_04/older_workers.htm.

13. Julie M. Whittaker, "Unemployment and Older Workers" (CRS Report for Congress, Congressional Research Service, August 29, 2007), http://www.aging.senate.gov/crs/pension27.pdf.

14. Bosworth and Burtless, "Recessions, Wealth Destruction, and the Timing of Retirement."

15. Social Security benefits taken between ages 62 and the full retirement age (FRA), currently 65 or 66 depending on birth year, are actuarially reduced so that the expected value of total lifetime benefits received is approximately the same regardless of when benefits are claimed.

16. Income earned by individuals who claim benefits prior to attaining the full retirement age (FRA) is subject to the retirement earnings test. There are two different exempt amounts depending on when the individuals attain FRA. For individuals claiming benefits and working in 2012 but attaining FRA in 2013 or later, the annual exempt amount in 2013 is $15,120. For those individuals attaining FRA in 2013, the exempt amount is $40,080 and applies only to income earned in the months prior to attaining FRA. After attaining FRA, individuals are no longer subject to the earnings test. SSA withholds $1 in benefits for every $2 in earnings in excess of the lower exempt amount and $1 in benefits for every $3 of earnings in excess of the higher exempt amount. US Social Security Administration, "Exempt Amounts under the Earnings Test," http://www.ssa.gov/oact/cola/rtea.html.

17. US Social Security Administration, "Retirement Planner: Getting Benefits While Working," http://www.ssa.gov/retire2/whileworking.htm.

18. For a summary of research work on this area, see Richard Burkhauser, Alan Gustman, John Laitner, Olivia S. Mitchell, and Amanda Sonnega, "Social Security Research at the Michigan Retirement Research Center," *Social Security Bulletin* 69, no. 4 (2009).

19. An aged beneficiary or "unit" is either a married couple living together or a nonmarried person, which also includes persons who are separated or married but not living together. A married couple's age is defined as the age of the husband—unless he is under age 55 and the wife is 55 or older, in which case it is the age of the wife. The example in the paper refers to aged units that are 65 years of age or older. In this case, the age of the married couple is the age of the husband if he is 65 or older; if the husband is younger than 55 and the wife is aged 65 or older, the age of the married couple is the age of the wife. See: http://www.socialsecurity.gov/policy/docs/chartbooks/fast_facts/.

20. United States Social Security Administration, "Relative Importance of Social Security, 2008," *Fast Facts & Figures*, August 2010, http://www.ssa.gov/policy/docs/chartbooks/fast_facts/2010/fast_facts10.html#agedpop.

21. Michael D. Hurd and Susann Rohwedder, "The Effects of the Economic Crisis on the Older Population" (MRRC Working Paper No. 2010-231, Michigan Retirement Research Center, Ann Arbor, MI, 2010).

22. Gayle Reznik, David Weaver, and Andrew Biggs, "Social Security and Marginal Returns to Work near Retirement" (SSA, April 2009), http://www.ssa.gov/policy/docs/issuepapers/ip2009-02.html.

23. Barbara A. Butrica, Richard W. Johnson, Karen E. Smith, and Eugene Steuerle, *Does Work Pay at Older Ages?* (Washington, DC: Urban Institute, December 2004), http://www.urban.org/uploadedpdf/411121_DoesWorkPay.pdf.

24. Geoffrey Kollmann, "Social Security: Summary of Major Changes in the Cash Benefits Program," May 18, 2000, http://www.ssa.gov/history/reports/crsleghist2.html. The option was created for women in the 1956 amendments and for men in the 1961 amendments.

25. Fullerton, "Labor Force Participation."

26. SSA, "When to Start Receiving Retirement Benefits," August 2012, http://www.socialsecurity.gov/pubs/10147.pdf.

27. Charles Blahous, "Social Security and Work," ***National Affairs*** 2 (Winter 2010).

28. Gopi Shah Goda, John B. Shoven, and Sita Nataraj Slavov, "Removing the Disincentives in Social Security for Long Careers," NBER, December 15, 2006, http://www.nber.org/programs/ag/rrc/NB06-06%20Goda,%20Shoven,%20Slavov%20FINAL.pdf.

29. See Testimony of Charles Blahous before the Subcommittee on Social Security of the U.S. House of Representatives Committee on Ways and Means, July 8, 2011, http://waysandmeans.house.gov/uploadedfiles/blahoustestimony78.pdf.

30. Goda, Shoven, and Slavov, "Removing the Disincentives."

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Responses to Questions for the Record From Jason J. Fichtner
Senate Finance Committee Hearing of May 21, 2014

Questions From Senator Brown

Question for the Entire Panel: The problems with the current retirement system can best be summed up into two issues: access and adequacy. First, do American workers have access to a retirement plan? This is a basic question for the fifty percent of workers without plans. Second, if workers have access to a retirement plan, are their resources adequate to support them or are they at risk of out-living their savings?

This second is of paramount concern to every American family. It is what keeps people up at night – will I have enough money to survive in retirement? To ensure adequacy, we need to focus on what works in the private savings market, so workers can save sufficiently.

What can we do so all workers can save for retirement. How can we supplement what they currently have? Can we use SSA to get workers into supplemental plans? Are there other ways to do this more efficiently?

Fichtner Response: Most Americans have access to a supplemental retirement plan and the majority of workers working at firms with employer-sponsored retirement plans elect to participate. Latest reports in March 2013 from the Bureau of Labor Statistics show that across the economy, 64 percent of private industry workers had access to retirement benefits even if there was only a participation rate of 49 percent. For employees working at businesses of 100 workers or more, 82 percent of private industry workers were eligible to participate in an employer-sponsored retirement plan even though the enrollment rate was only 65 percent. Among workers earning below the median household income, the majority chose to enroll in an employer-sponsored retirement plan if the plan existed. According to the Employee Benefit Research Institute, 72 percent of workers earning between $30,000 and $50,000 a year choose to participate in their employer-sponsored payroll deduction retirement plan if it exists. Of the other 28 percent of workers, only 5 percent set aside money through an IRA. There is substantial room for greater use of IRAs. The Social Security Administration has the opportunity to play a unique role in increasing financial literacy and awareness of the benefits of saving for retirement early. Better educating people about the full benefits of saving early may lead to more people saving for retirement through IRAs. Encouraging greater use of IRAs would be particularly helpful for part-time workers that may not have access to employer-sponsored retirement plans – only 37 percent of part-time private sector employees are offered a retirement plan.

Although there seems to be sufficient access to retirement options for most Americans, there is an enormous shortfall of resources in those retirement accounts. According to the National Institute on Retirement Security, the median retirement savings of household nearing retirement is just $12,000.

These numbers suggest that Americans are saving insufficiently for retirement even though many have access to both employer and individual retirement accounts. Encouraging greater financial

literacy, as the SSA has emphasized in the past, may be instrumental in increasing the savings rates of households. As I mentioned in the hearing to a question by Senator Nelson, I helped SSA develop a 2-page handout that should be used in every Social Security field office to help people make the important decision on when to start receiving social security benefits. Delayed claiming results in a higher monthly benefit amount which would then provide great financial assets during the later years in retirement when people are most likely to need additional financial resources. The publication / handout is available online here: www.ssa.gov/pubs/EN-05-10147.pdf – *and, again, should be available in every Social Security field office.*

Question for the Entire Panel: Social Security's benefit formula provides tiered, progressive, and modest benefits. We think about this in terms of both income and replacement rates, how much you are able to replace from the average of your highest 35 years in the workforce. We see that these benefits are extremely modest. For workers with average wages the replacement rate is 42%, for a cash benefit of $18,200 a year. For low-income workers, the replacement rate is 77%, but the cash benefit is a below-poverty amount of $8,500.

Along with Senator Harkin, I have proposed modestly increasing the benefit formula by increasing the first bend point in the Social Security formula for newly eligible beneficiaries. I would like the panel's reaction to this proposal. Is this an appropriate way to update the benefit formula?

Fichtner Response: Expansion of the first bend point in the Social Security formula for newly eligible beneficiaries would encourage earlier retirement among low-income workers and discourage labor force participation and future economic growth. However, the choice does not need to be between greater savings OR strong labor force participation. Reforms such as increasing the delayed retirement credit and providing payroll tax relief for low-income workers who extend their working lives would assist in accumulating savings for retirement while maintaining a greater level of labor force participation. Additionally, as I mentioned in my testimony, if the goal is to provide a larger benefit for lower income workers, instead of increasing the first bend point, which would increase the benefit for all people – low and high income alike – an increase in the minimum benefit level could be adopted.

Question for the Entire Panel: One of the guiding principles of Social Security is that the program works off of an insurance model. Premiums are the years that you pay payroll taxes into the system. This is important because the collective ownership and near-universal participation are part of the program's strength.

There is one important exception I would like to solicit the panel's reactions to it. Women are more likely than men to take career breaks to care for a child or another relative. And low-income workers are more likely than their better off peers to leave the paid workforce to care for a family member. Taking time off from work to raise a child or care for an ill family member should not be mistaken for a vacation. This is hard, important work and it is work that gets no credit is the Social Security benefit calculations. Given this, should Social Security include a caregivers credit that would make sure these workers receive some credit for these years of work when calculating their Social Security benefit?

Fichtner Response: It should be noted that Social Security already redistributes income to stay-at-home spouses irrespective of whether they are caring for a dependent child or not. Currently, the social security program pays a much lower rate of return to single working parents (whether they be mothers or fathers), as well as to two-earner couples, than it does to one-earner couples. Creating a caregiver credit would further exacerbate this already aggressive redistribution of income.

That said, homemakers play a valuable role in the economy. They are busy rearing the next generation, caring for ill family members, and maintaining a certain standard of living at home. At the same time, it is important to recognize that some homemakers that would like to return to work face significant penalties for doing so. Current Social Security policies provide disincentives to taxpaying work from a second income earner. For example, incremental returns on taxes paid by women have been estimated at -32.0 percent relative to what they would receive by staying out of the paid workforce altogether and instead often collecting the nonworking spouse benefit. Instead of adopting a caregiver credit, a potentially different approach would be to develop a "fertility-neutral" payroll tax that encourages childrearing. The benefit side of Social Security already attempts to recognize some of the value of parenting, both through its nonworking spouse benefit and through specific benefits for dependent children. None of these, however, attempt to recognize the ultimate financing contributions made and current burdens borne by parents during the time of their parenting. As I have written with my co-author, Charles Blahous, a more "fertility-neutral" payroll tax would be to increase the basic payroll tax rate while creating exemptions or deductions for each dependent child. This, of course, is already done in the federal income tax. But whereas in the federal income tax structure the current exemptions reflect the results of a political negotiation, it is at least theoretically possible to base adjustments to create a fertility neutral payroll tax structure solely on what is actuarially fair. For more information, please see "Limiting Social Security's Drag on Economic Growth: Removing Disincentives to Personal Savings and Labor Force Participation," Fichtner and Blahous, November 1, 2012. Available online here: http://mercatus.org/publication/limiting-social-securitys-drag-economic-growth .

Question for the Entire Panel: If a beneficiary retires, dies, or becomes disabled, Social Security pays benefits to his or her children until age 18 or 19. In the past, children of beneficiaries who attended high school, college, or vocational school continued to receive benefits until age 22. Why did Congress end this benefit and do you believe it would be valuable to restore it? How much would it cost to restore?

Fichtner Response: It is my understanding that the benefit for children greater than 18 years of age was reformed because it was generally seen as a social security student benefits program for those in school and was criticized on the grounds other federal assistance programs are better targeted to providing assistance to students than the social security program. Further it was argued that the payroll tax system that funds the social security program could be considered an inappropriate method of financing college students. I think the arguments that led to curtailing these benefits in the first place still hold merit and that Congress should not consider reinstating this particular benefit. As for the cost of doing so, if such a benefit were to be reinstated, I will defer to SSA's Office of the Chief Actuary for a cost estimate.

Fixing the US Retirement System

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Committee on Finance
Subcommittee on Social Security, Pensions, and Family Policy
United States Senate
215 Dirksen Senate Office Building
Washington, D.C. 20510
May 21, 2014

10:00 – 12:00 am

Written Testimony

Summary

Independent experts agree[1] that most Americans will not have enough retirement income to maintain their standard of living into old age. They agree that the next generation will do worse than their parents and grandparents; that more middle and lower income elderly will look for work to make ends meet; and that Social Security will become an even more important source of income to elderly households. The individual-directed, commercial, voluntary and tax subsidized employer system has not and will not become an important source of income for most older Americans. American workers need a tier of advanced-funded retirement accounts that have many features of the Social Security system. Americans need a mandatory, universal, advanced funded retirement account that is professionally managed, is appropriately tax-subsidized and pays out annuities.

The lobbying organization for the mutual fund companies, the Investment Company Institute, ICI claim that despite pessimistic research the ICI finds that retirees are doing better than their previous generations and that more retirees receive more income from private sector retirement plans and that $23 trillion earmarked for retirement are at record levels. They also claim government statistics undercount the income retirees receive from IRAs.

Current retirees are doing better than previous generations, we can't overlook our success, but baby boomers will have less security than their parents and grandparents because they have more debt; need to look for work at advanced ages; have less secure retirement asserts; and the assets are skewed toward the very highest income retirees. Though IRA assets are growing the system is irrelevant for most people; the top 20% of baby boomers own 72% of all retirement assets.[2]

The current system of self directed, voluntary, commercial accounts subsidized by tax deductions

-- not tax credits -- that allow preretirement withdrawals is stacked against most workers for 4 major reasons:

1. Middle income and below are more likely rationally take loans from their 401(k) or withdraw monies from their 401 (k) or IRA. The federal government collected 37% more from early withdrawals than it did in 2003. Low income workers early withdraw at twice the rate high income IRA and 401(k) holders do.[3] Younger workers cash-out rate more. 40% of workers aged 20-39 years old cash out to a large loss -- a 30-year-old who cashes out a $16,000 account will be losing an estimated $471 a month at age 67.[4]

2. Tax breaks are higher for high earners so middle and high income workers saving the maximum are treated differently. The high earner gets a higher after tax rate of return.

3. Middle and below income savers rationally have more conservative portfolios which earn less;

4. Middle income and below savers pay higher fees proportionately because they don't receive the best advice and because their accounts are smaller;

This means the wealthiest savers receive a higher rate of return just because of the structure of the system. The built-in increase in the net of tax and fees rate of return after just a few years yields huge gaps and even the same level of an account, by a minimum 15% difference.[5]

The government system should help people in like situations the same and not make wealth distributions more regressive. All workers need a supplemental retirement plan that invests their savings efficiently with low costs, earns a secure and sufficient rate of return, and preserves savings for retirement. Therefore, the policy challenge is to expand access to individual account-based retirement plans and to address the critical failures in the existing system by making a new retirement savings vehicle available that meets three key criteria for retirement income security:

- Helps workers make adequate retirement account contributions and prevents early withdrawals.
- Provides low-cost, quality investment vehicles that are professionally managed and helps shield individual workers from investment and market risks.
- Provides a lifetime guaranteed stream of income at retirement.

Creating a nationwide, individual retirement plan that incorporates the goals of adequate contributions, safe and appropriate investments, and lifetime income, would efficiently and practically solve the upcoming retirement crisis. But if the nation's policymakers won't act, each state can tailor a State Guaranteed Retirement Account plan—which meets all of the above criteria for an efficient and adequate retirement savings plan—to meet their unique needs and to secure retirement income for each state's workforce. 10 states are well on their way to creating such a system.[6]

Congress can do a lot better. Even with liberal tax breaks, enabling regulation, and vigorous and expensive marketing by the financial industry of IRAs and 401(k) plans, coverage in any kind of plan continues to erode. Only 53% of the workforce have a retirement plan at work, down from 60% ten years ago. The IRA/ 401(k) platform will not serve the needs of most retirees and workers.

How did Retirement Income Become Inadequate?

Let us take a victory lap and not lose sight of our successes. The poverty rate for American elderly has been cut by four fifths since the expansion of Social Security starting in the mid 1950s. One of the hallmarks of the American system of social insurance -- which include generous tax breaks, employer pension plans, disability insurance, early retirement plans and Social Security -- is that working people, rich and poor alike, can afford to retire. And, so far the people that have the shortest life spans can still retire at younger ages than those workers who tend to live longer and who control the pace and content of their work lives.

Indeed that workers – middle class, low income, and high paid can have a healthy period of old-age leisure is the success of a civilized society.

Yet, there is a sea change in retirement security and the public know it.

Worry about the upcoming retirement crises may be one of several areas where "the people" are ahead of the politicians. Polls – for instance McKinsey & Company[7] and Gallup [8]) find people want government to help guarantee retirement income more than they want government job guarantees. Women,[9] higher income individuals, and whites are more anxious about their retirement future and fear "things" are going to get worse than were men, lower income people or minorities. All income classes have retirement worries, higher income and white professionals fear the most losses and experience relatively more insecurity.

Worry is justified. Experts agree that almost all middle-class workers working now won't have adequate retirement income even if they try and work well into their late 60s. (The average age of mostly permanent withdrawal from the labor force retirement is about 63). Low and middle income workers have a greater chance of being old and poor than they had in the past and high income workers have worries particular to "living too long" – paying for high end of life health costs and their money not lasting as long as their lives.

And Baby Boomers will do worse than their parents and grandchildren in terms of lifetime leisure. Most retirees are getting less income from retirement assets and more from work.

Income Source	Point Change from 2000 - 2010	Share of total income coming from each source for households with members over age 65	
		2010	2000
Social Security	+1	37%	38%
Assets: 401(k) and IRAs	-7	11%	18%
Pensions: DB plans	-3	15%	18%
Labor earnings	+29	30%	1%

http://www.ssa.gov/policy/docs/statcomps/income_pop55/2010/sect10.html

What do people need to retire comfortably?

How much should workers have in their IRAs and 401(k)s? "I am 45 now and have about $40,000 in my IRA, will that be enough? I am asked a version of that question all the time. And face to face it's psychologically hard to answer truthfully because they want to hear only one answer. Yes, you have enough. (When doctors tell their patients to lose weight people would answer, I am big boned. The BMI takes care of excuses. We need an equivalent index like the BMI to answer the queries about retirement readiness.) Below are rules of thumb for judging whether Americans are on track for an adequate retirement.

At retirement people need about 15 times their salary to live comfortably.[10] Social Security and Medicare gives the average worker about 5 times their salary so an average income worker needs about 10 times their salary, or $50,000 times 10 is $500,000, in a retirement account (the amount varies by what rate of return net of tax is assumed). (A DB plan can provide the bulk of that asset, but fewer people will have life-long DB plans.) This account balance will provide a retirement income of a target 60% to 89% of preretirement income.[11] However, there is an emerging consensus that middle and high income people need 95% to 100% of pre-retirement income to maintain living standards because more elderly are in debt[12] -- still paying mortgages -- and that health care costs are increasing.[13]

Americans are way off the mark to having anywhere near a half a million in their retirement account.

Most Americans have no retirement assets including workers who earn top salaries. One out of five workers in the top 25% of all earners have no retirement assts. (The latest numbers from the federal government show that over three – fourths of low income individuals -- 66% of people in the second quartile, 41% of the third quartile, and a quite large 22% of the top quartile have zero retirement account balances.) Individuals in the top quartile earn on average earn over $100,000 per year so they need over a million dollars in their retirement accounts at retirement, but, on average, they have only $140,000. [14] These balances convert to about $5,000 a year – a dinner and movie once a month.

What do people at all income levels have to save to reach target replacement rates?

Aon Consulting -- the AON Consulting Group has been analyzing the needs of retirees since its first report for the President's Commission on Pension Policy in 1980 -- has provided that answer in terms of what deduction is required for a worker to achieve a sufficient account balance at retirement. If people start saving 5% in their 20s and keep that contribution rate constant, do not withdraw or take loans against it, and have it well invested they will have enough.

If a worker starts at age 40 they would have to save over 25.8% of their gross income per year until age 65 to achieve an 80% replacement rate. If workers lose all of their retirement accounts and have to start fresh at age 50 they would have had to contribute half of their earnings. No OECD, rich, country outside of the United States leaves workers without a mandatory and universal system providing early and consistent retirement savings. We do not have appropriately safe and secure retirement account institutions in place that allow Americans to save enough to achieve adequate replacement rates. [15]

Institutions do Not Help Workers Save Enough

Source Aon. 2008

	Required Savings (Percent of pay that needs to be saved each year until age 65, if saving starts at age 25 (this assumes a whopping 7.7% return)	
Annual Income	If savings starts at age 25	If savings starts at age 55
$30,000	4.2%	32.8%
$50,000	4.1%	31.9%
$90,000	5.8%	44.9%

People with DB plans and Social Security have adequate retirement income and a small chance of being poor or near poor adults. [16]

In summary, the average working American age 55-64 earns $48,542 per year, and has accumulated a net worth (including home equity) of $263,167, five times earnings. They need about twice that amount (target range $388,336- $485,420).

Why Doesn't The Current System Help Most Workers Accumulate More?

Our system does not treat people equally and creates inequality. Much of the unequal treatment is unintentional. According to conservative public finance practices every tax and government spending program should strive for vertical and horizontally fairness. People in like situations

should be treated the same and everyone up and down the wealth and income scale should make approximately equal sacrifices for equal return.

But lower income earners saving the maximum they can in a tax qualified account are not treated the same as a high earner saving the maximum they can in a tax qualified account. [17] This happens for four reasons: 1.) the tax code gives a higher rate of return to the high earner even if everything about the portfolio is the same; 2.) Because of self direction lower income workers rationally choose safer, lower earning assets; and 3.) Lower income workers pay higher fees for the same effort. 4.) Because of the uniquely American feature that workers can take tax qualified retirement savings out before retirement, low income workers are more likely to take out costly loans, cash out, and by liquid assets.

Low income workers, have of course, less in their accounts than high income workers. They have, on average, $15,000 in 401(k) savings by their 30s which grew to just under $49,000 in their 60s. High earners,[18] have on average $80,000 saved in their 30s and $200,000 in their 60s. The disparity in 401(k) balances is not only a function of salary. Higher income earners tend to allocate more of their 401(k) funds to be invested in equity funds.[19] Due to this apparent risk aversion, lower income workers will tend to lag the return performance of their higher paid counterparts over the long-run.[20] This gap arises because the current system leaves all investment choices up to the individual savers.

Differential use of loans taken out against 401(k) account assets creates retirement: a full 25% of low-income earners reported having a loan outstanding with an average loan size of 17% of the account balance. Only 19% of higher income earners had loans, in the size of 12% of account balance (see Urban Institute work and new work by Robbie Hiltonsmith). [21] Leakages are only an issue because the system allows savers to borrow against their accumulated balances.

Moreover, the current tax break is top heavy; it helps only the higher income, the best-off workers, saves for retirement. 80% of the tax breaks for retirement savings go to the top 20% of older workers. High income workers get up to $7000 in tax breaks while low income workers get zero, even if they save the maximum. Because higher income workers get better returns and more tax breaks, and because they are less likely to withdraw from their retirement savings, the wealth gap between rich and poor explodes just because of the way the system is structured.

For 30 years Congress expanded subsidies to the 401(k) and IRA form of pensions because they held much promise. But, despite the tax subsidies, a huge amount of advertising, increased financial literacy and growing concern about Social Security, 401(k) plans cover fewer people than they ever did before.

Solutions for Inadequacy: More Savings in a Good Pension System

So how do we help Americans save for retirement in a way that is fair and universal? The answer is based on two social norms and standards. One: that most people want to and should be able to preserve preretirement living standards into retirement; and, two: that income and wealth gaps should not be encouraged to grow after retirement.[22] Only if people saved continuously starting at age 25 only the highest income earners come close to saving enough for retirement.

There is very little "definition" to "defined contribution" plans. Employers stop and start contributions and vary the matches. Also benefit disbursements from defined contribution (DC) plans fluctuate along with the stock market and are very erratic. For these and other reasons, 401(k) plans are implicated in the decline of retirement income security for middle income workers. Firms who handle 401(k) plans assets admit there business models focus on the top earners. If the tax breaks for 401(k) and IRA were reduced or eliminated the top 1% would shoulder 48% of the subsidy loss and general revenues would increase by over $100 billion to spend on more retirement plans, or youth programs or bridges to somewhere.[23]

The solution to the upcoming retirement crisis in the short run is an expanded Social Security system and the creation of appropriate savings vehicles like a "Guaranteed Retirement Account" or Secure Choice Accounts now being established in 5 states and being considered by 5 more. The GRA plan would supplement Social Security income for every worker in an effective and efficient way.

The guaranteed retirement account would have everyone accumulating in a retirement fund as they do in many other countries like Australia. The plan would provide a safe, secure and effective low fee investment vehicle like many in United States have; for instance, my own pension plan, TIAA-CREF, and many other defined-benefit plans across the country. GRAs would disallow pre-retirement withdrawals. Only partial withdrawals would be allowed. We are the only country that allows people to take tax preferred money for retirement before retirement.

There are a few common elements experts say efficient, effective, sustainable, and fair retirement pension systems should have. Compared to 401(k) plans in the private sector high performance retirement plans have these characteristics:

- every worker is covered;
- employees steadily contribute as they are working;
- the contribution rates are high enough to yield an adequate retirement supplement;
- assets are managed professionally;
- No withdrawals before retirement
- money management is pooled so that the fees are low and the investment decisions are professional;
- government subsidies go to the people who need it most;
- Payout is in the form of annuities and at retirement – only a partial lump sum should be possible;
- a person's pension savings are not lost when changing jobs.

Employers' needs are often bypassed when discussing retirement plans. But, I can't emphasize this point enough; the pension systems sponsored by employers must meet employer's needs. In the public sector the employer are the taxpayers. A change in pension design will likely increase savings rates, stabilize employer relations, and reduce inequality and deprivation among American elderly.

Conclusion

One of the biggest hurdles to spurring retirement savings is that half of workers don't have access to a retirement account through their employer. Many work for small businesses, which often lack resources to navigate the relevant regulations. To help these workers, the federal government should provide "off-the-shelf" options that businesses can offer to workers with limited regulatory burdens. Another form of help would be to require more pensions savings as public sector pensions do.

A popular reform proposal is to require that workplace retirement plans should also enroll workers automatically but let them opt out. Though auto-enrollment increasing participation in employer-sponsored plans as high as 95 percent the contribution rates savings rates are insufficient for retirement adequacy.[24] There is also evidence that people may accommodate increased savings at work by taking on more debt somewhere else in their portfolio or save less in other ways.

Ironically not mandating retirement savings is expensive and ineffective.[25] Policymakers have been incenting individuals to save in inadequate retirement savings vehicles and the incentives are expensive and targeted incorrectly. A $50 billion savers' tax credit is a good idea but more state governments and the Obama administration should followup on their conclusion that $170 billion in just federal tax subsidies for 401(k), IRA and other retirement accounts are lopsided and don't increase savings appreciatively by turning the deduction to a credit which would give every workers $600. If states with income taxes also did the same, every American would have a retirement account and every account would have more -- except for those at the very top who get the largest tax subsidies. Policy changes to improve workplace pensions would be a mandate savings rate of 5%. A GAO report[26] laid out four alternatives on these lines. There are 4 good solutions to improve the financial security of middle class working Americans.

Retirement needs and expectations are based on social norms and practical considerations. No modern nation has found it practical to rely on individuals saving enough for retirement in voluntary, commercial, individual-directed accounts with distorting tax treatments. The consequences of no change is an underperforming retirement income security system that will result in an increase in elderly poverty rates and a continuing decline in living standards for older Americans, many who have worked 40 or more years.

Appendix: **What Not To Do: Don't Rely on Increasing the Retirement Age**

Americans work longer than most other people in rich nations and die sooner. There is some policy attempts to change norms in the US about retirement age and time. The hope is that people working more will save money for pension systems, the economy will grow, and people will like the work. But hope about working longer confuses longevity with working ability, ignores facts that employers hire workers and match them to jobs according to profitability motives not public policy motives, and that improved longevity and wellness in old age is not distributed equally. Higher income white males have enjoyed the largest increases in longevity:

the use of statin drugs and reductions in cigarette smoking are key factors. White men and black men in 1950 at age 65 remarkably were projected to live the same number of years after retirement. Now white men at 65 with live 2 more years or 15% longer than black men. See the table below.

White Men's Longevity Improvements Are Increasing Faster than All Other Groups

Years of life expected for those age 65

	white men	white women	black men	black women
1950	12.8	15.1	12.9	14.9
2009	17.7	20.1	15.8	19.3
Improvement 1950 – 2009	38.3%	34.4%	22.5%	29.5%

(source: National Vital Statistics Reports: January 2014 http://www.cdc.gov/nchs/data/nvsr/nvsr62/nvsr62_07.pdf)

Compared to established OECD nations, American work more hours per year and more after age 65. American longevity for seniors is shorter than most established OECD nations. Overall longevity for 65 year olds has increased approximately 25% -- though the improvements are greater for white men since 1950; the economy (GDP per capita) has increased 244%. Overall time spent in retirement has increased to be sure as employer pensions and Social Security expanded. Society has chosen to use the increases in prosperity to increase retirement time.

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2012 EBRI/ICI 401(k) database)

ENDNOTES

[1] Urban Institute shows inadequacy is growing by birth cohort. http://www.urban.org/UploadedPDF/412490-boomers-retirement-income-prospects.pdf. See reporter Steve Greenhouse's New York Times article interviewing experts from all political perspectives agreeing..

[2] One of the best written essays on why the retirement crises is overstated is from Sly Schieber mountain<http://www.towerswatson.com/en-US/Insights/Newsletters/Americas/insider/2013/employer-pensions-individual-retirement-savings-and-retirement-income-provision>" but the data is questionable. Monique Morrissey <http://www.epi.org/blog/retirement-crisis-mirage/#_note1> addresses Syl Schieber's claim that the retirement crises is overstated. She notes that aggregate assets in retirement accounts are large and growing but extremely concentrated at the top of the income distribution. They will not provide significant retirement income for the vast majority of Americans. John Turner, David McCarthy and Norman Stein<http://www.iijournals.com/doi/abs/10.3905/jor.2014.1.3.113#sthash.exTFWtjy.dpbs> show there are 165,000 retirement plans with average account balances greater than $3 million, though some may not qualify for tax benefits. This includes one 401(k) plan with three participants and an average balance of $240,000,000. Similarly, 1% of households had more than $1.3 million saved in retirement accounts, and households in the top fifth of the income distribution accounted for 72% of assets in these accounts.

There is enormous wealth in 401(k) and IRAs. But the existence of outsize account balances has no bearing on whether ordinary workers can rely on savings in these accounts to finance a decent retirement, and the billions missing from the CPS data don't amount to much for most workers. The inequality of retirement asset distribution can be seen by the difference between the median and average disbursement. Very few high values can drive up the average but the mean describes what the annual retirement income that half of retirees get less of and half get more. The median disbursement was zero, 81% of retirees get nothing from IRAs. For households in the peak saving years (55-64), the median account balance in 2010 was $12,000<http://www.nirsonline.org/storage/nirs/documents/Retirement%20Savings%20Crisis/ret

irementsavingscrisis_final.pdf>, too small to make a meaningful difference in retirement. Though the median balance for households with savings in retirement accounts was $100,000<http://www.federalreserve.gov/pubs/bulletin/2012/pdf/scf12.pdf>, this not only represents the 70th percentile for this age group as a whole, it also translates into an annuity worth less than $5,000 a year. Another way to see how average values distort the health of retirement savings can by seen by the

Social Security Administration report that found <http://www.ssa.gov/policy/docs/ssb/v73n2/v73n2p77.html> that while the average disbursement for senior households receiving IRA disbursements was $8,121 in 2009, only 19% of senior households received any disbursements at all. Taking into account seniors that received nothing means the overall average disbursement received among all senior households was only —$1,543 per year. These are total disbursements as measured in the Survey of Income and Program Participation (SIPP) which is a more complete data set, more complete than the CPS Sly Schiber uses. Morrissey argues, that unequal distribution of IRAs and 401(k) plans is lending support to those who, like Michael Lind and President Obama<http://www.pionline.com/article/20130415/PRINT/304159965/obama-budget-to-cap-retirement-deductions>, want to restructure <http://www.offthechartsblog.org/author/huang/> tax subsidies to better target them to low- and middle-income households. <http://www.epi.org/blog/retirement-crisis-mirage/#_ref1>

(The annuity values calculated in this endnote uses the Thrift Savings Plan Retirement Income Calculator<https://www.tsp.gov/planningtools/retirementcalculator/retirementCalculator.shtml> based on the following assumptions: the annuity starts when a couple are both aged 65, the interest rate is the current TSP annuity rate of 3%, and the annuity provides a 50% survivor benefit with rising payments to offset inflation. A 20-year annuity at the 3% interest rate translates into a $6,700 annual payment but loses value with inflation and offers no longevity protection.)

[3] Barbara A. Butrica, Sheila R. Zedlewski, and Philip Issa, 2010 "Understanding Early Withdrawals from Retirement Accounts," Butrica, et.al. Urban Institute, May

[4] http://www.napa-net.org/news/managing-a-practice/industry-trends-and-research/withdrawals-from-401k-plans-may-be-replacing-home-equity-loans/?id=65852&tkn=21471348605335fd2dc3116&mqsc=E3772376&utm_source=WhatCountsEmail&utm_medium=NAPA_List+Napa-Net%20Daily&utm_campaign=NAPA%20Net%20Daily

[5] Adam Hayes, graduate student in the Economics Department at the New School for Social Research, helped calculate how much the built-in difference affects workers' savings. The difference in expected rate of return after just a 10-year period just because of an asset portfolio difference yields huge gaps in accounts that started at the same level and accepts the same level of contributions. Two accounts, identical in every way except for the income of the contributor will be treated differently in our system. A $40,000 (real terms) a year worker who saves $5,000 a year and workers earning $100,000 per year saves might save the same amount, say $5,000 a year, and allocates it like a typical high income earner -- the higher income worker would have earned an estimated 6.23% rate of return and a $40,000 per year worker an estimated 5.86%). If extrapolated over a 40 year career, that mere difference in allocation would result in the higher

income earner's nominal return being over 14.5% larger than his low income counterpart. For plans that include company stock, the gap becomes even larger. Of course with the lower risk aversion comes higher risk and the potential for larger losses during an economic downturn. However, the rate of return benchmarks used in the above calculation are for the past 10 years, inclusive of the great recession. Also these rates of return are gross rates, I did not estimate typical fees given different kinds of accounts, but in a 401(k) structure I believe that they may be similar across strategies.

The asset allocation mix is found in the EBRI/ICI 401(k) database.

benchmarks are:
Source: Vanguard Inc.
10-Yr Annualized
Benchmarks: Return
MSCI US Broad Stock Index 8.20%
Barclays Aggregate Bond Index 4.79%
Balanced Fund* 7.02%
Money Market 0.99%
Target Retirement (2035) 5.34%

*Balanced Fund performance is computed from: Weighted 60% Dow Jones U.S. Total Stock Market Index (formerly known as the Dow Jones Wilshire 5000 Index) and 40% Lehman Brothers U.S. Aggregate Bond Index through May 31, 2005; 60% MSCI US Broad Market Index and 40% Barclays U.S. Aggregate Bond Index through December 31, 2009; 60% MSCI US Broad Market Index and 40% Barclays U.S. Aggregate Float Adjusted Index through January 14, 2013; and 60% CRSP US Total Market Index and 40% Barclays U.S. Aggregate Float Adjusted Index thereafter.

[6] http://www.pionline.com/article/20140512/PRINT/305129971/states-pushing-to-offer-retirement-accounts-to-private-sector

[7] ttp://www.mckinsey.com/clientservice/financialservices/pdf/Winning_the_Retirement_Race.pdf

[8] Gallup poll April 22, 2014 retirement security. The April 22, 2014 Gallup Poll listed retirement security as the key worry of middle class families "not having enough money for retirement" received more responses than "Not being able to pay medical costs, not being able to pay off debt, monthly bills, etc."

[9] http://www.iwpr.org/publications/pubs/why-americans-worry-about-retirement-security-and-why-women-worry-more-than-men

[10] Adequacy -- simply the ability of a retiree to sustain a customary quality of life without the fear of running out of money – is measured by the ability of a worker to achieve a certain replacement rate, post-retirement income as a percentage of pre-tax income before retirement.

[11] A number of researchers have come up with guidelines for what an appropriate replacement rate (aggregated from all income sources) should be for a married couple earning more than $50,000/yr before retirement: The RETIRE Project at Georgia State University estimates that number should be 80%. AON Hewitt Consulting in 2012 recommended a target of 85%, and a comprehensive survey of financial planners and educators found that a replacement rate of 70

percent to 89 percent of previous earnings was deemed appropriate, with mean and median recommendations of 74 percent and 75 percent respectively. TIAA-CREF meanwhile suggests a target replacement rate ranging anywhere from 60-80%. The adequate replacement rate varies with preretirement income because higher income workers pay a higher percentage of preretirement income in work related expenses – especially in taxes and saving for retirement. So that high income individuals – defined here as the top 20% -- need a lower replacement rate than lower income workers (defined as the bottom 40%). For middle class workers 80% of preretirement income is the standard. It is also assumed that since people have more time in retirement, it is assumed that they will replace expensive activities with time intensive activities (more home meals etc.) However, the presumption that people need less income in retirement has been challenged by the fact uninsured health costs are higher in retirement and over half of the elderly are retiring with mortgage.

[12] Loonin, Deanne; Renuart, Elizabet. 2007. "Life and Debt Cycle: The Growing Debt Burdens of Older Consumers and Related Policy Recommendations," 44 Harv. J. on Legis. 167

[13] Reno, Virginia P. and Joni Lavery. 2007

[14] Based on the 2010 Survey of Consumer Finances, adjusted for wage inflation. If we take into account other assets owned, 30 percent of U.S. households near retirement age (ages 55-64) have less than $10,000 in liquid assets— i.e. they have virtually no financial assets to annuitize. The next 24 percent - those who have assets between $10,000 and $99,999 – also have very little to annuitize (annuitizing $50,000 for a single male age 65 in 2013 yields $68 per week, while for a married couple where both members are age 65 in 2013, they would receive $56 per week). In other words, 54 percent of near retirement households in U.S. have too little in retirement accounts and will rely almost exclusively on Social Security and any defined benefit pensions they may be eligible for to fund their retirement years.

[15] According to the Bureau of Economic Analysis, the personal savings rate in the United States in 2010 was 4.8%, and that is projected to decline to only 2.7% by the year 2020.

[16] We have done detailed analysis of poverty projections of near retiree households by plan type. The New York City and California data are published. http://www.economicpolicyresearch.org/images/docs/SCEPA_blog/guaranteeing_retirement_income/Downward_Mobility_Amongst_New_Yorkers_FINAL.pdf

[17] Salary range of $20,000-$40,000/yr, using 2011 data

[18] Salary range of $80,000-$100,000/yr, 2011 data

[19] 49.2% allocation vs. 40.4% allocation. For plans that included company stock, high earners allocated a total of 55.7% of funds to be invested between equity funds and company stock while low income earners allocated 45.1%.

[20] Using data from the 2012 EBRI/ICI, we determined that a low-income worker, merely due to her or his choice of investments earns on average around 30 basis points less than if he invested the way a high-income earner does (5.85% CAGR vs. 6.16%). If extrapolated over a period of 40 years, the low-income earner has approximately 15% less in retirement funds than the same worker would had she or he invested more aggressively.

[21] See Urban Institute paper cited above and New School graduate student Robbie Hiltonsmith)

[22] Low income workers need more income in retirement than while they were working because their preretirement income was at the poverty level. Low income workers should have replacement rates higher than 100% of preretirement pay. There is some support to raise incomes of the very poor and very old – this group is among the most "deserving poor" – but the responsibility for this group is generally out of the hands of employer pensions.

[23] Burman et. Al. 2004, 2009

[24] GAO 2009 "Automatic Enrollment Shows Promise for Some Workers, but Proposals to Broaden Retirement Savings for Other Workers Could Face Challenges", October

[25] Bubb, Ryan and Richard H. Pildes. Forthcoming 2014. "How Behavioral Economics Trims Its Sails And Why' Harvard Law Review.

[26] Alternative Approaches Could Address Retirement Risks Faced by Workers but Pose Trade-offs. GAO-09-642: Published: Jul 24, 2009. Publicly Released: Aug 24, 2009. http://www.gao.gov/products/GAO-09-642

Responses to Questions for the Record From Teresa Ghilarducci
Senate Finance Committee Hearing of May 21, 2014

Questions From Senator Brown

Question for Dr. Ghilarducci and Mr. Goss: Everyone on this panel and on this committee can agree that the Financial Crisis and subsequent recession did enormous damage to the American economy and working family's retirement savings. Now, five years later, the economy is slowly healing but the stock market and corporate profits are at all-time highs. This has not translated to a dramatic improvement in the retirement picture. What is going wrong and why is there a disconnect between the stock market and private retirement accounts?

Answer

Members of our panel and the committee agreed that the Financial Crisis and subsequent recession did enormous damage to working family's retirement savings. Now, five years after the start of the recovery which began in March 2009, the stock market and corporate profits are at all-time highs but retirement readiness has not gotten worse.

Why? Simple math. Losing assets when you are an older worker with assets, permanently derails retirement plans. Here is a simple example. Take Joe. Joe knows that assets for a retirement at age 67 (with plans to live until age 92 – though only 15% of 57 year olds will live that long – he needs at least 10 times his annual salary at age 67. So "Ideal Joe" behaves like the ideal planner. Joe earns the median wage, $50,000, he was 57 in 2008 and will retire at 67. Joe saves 10% of his income and constructs a portfolio designed to earn 7% return. He starts out 2008 with a nice $250,000 and he was on track to have $563,000 at age 67. Joe was all set for an adequate retirement income.

Whack, the crash comes and his portfolio takes the average hit of 25%. Joe is lucky, he doesn't do what many people did in the crash – reduce his savings effort to pay off credit cards, or lose hours or his job, or bail out any of his family members also hurt by the recession. Joe is a steady Eddy, lucky to keep his job and maintains his savings efforts. But, by 2009, he is one year older and down $50,000. Now, he will only have $429,000 at retirement, not over $563.000. And he won't have enough.

Joe's loss is permanent for two reasons: (1) compound interest and (2) aging. The stock market recovered; but the losses in 2008 never recover, the stock market returns, now higher and positive, for Joe only grows his much lower asset base. Crucially, he lost a year of time, he continued to age, that year is never recovered. This is one reason asset values have not increased relative to the need. Real people also lose their jobs and income in crashes, further eroding assets. There a disconnect between the stock market and private financialized retirement accounts.

Basing an individual's retirement income on financial asset accumulation is inefficient and could cause certain cohorts, like the baby boomers who, through no fault of their own were older workers during a crash, to permanently lose retirement living standards only because they were in their mid-fifties when a crash came. It is our system's reliance on financial assets that created a large part of our retirement crises. Expanding Social Security and mandatory DB/DC hybrids would be cheaper and more reliable.

Question for Dr. Ghilarducci: Employers are given every possible incentive to offer retirement plans. Congress has built the tax-preferenced, defined contribution system. Money managers have expended considerable resources developing this system. There has been a great deal of money spent on advertising to encourage employers to offer a plan and then to have workers participate in these plans. Despite all these efforts, we know 50 percent of workers are not offered a retirement plan of any kind and even among those who are offered a plan, far too many do not participate.

Can you offer any insight into why that is the case?

Answer

Congress has, indeed built a system with very generous incentives to employers to offer retirement plans. Congress built the tax-preferenced, defined contribution system with light regulations on advice and management fees and behavior. And, you are right, private sector money managers have expended considerable resources developing this system, including advertising and marketing to encourage employers to offer a plan and workers to participate in these plans. However, 50 percent of workers are not offered a retirement plan of any kind and that offer rate is decreasing. And even among those who are offered a plan only about 83% participate.

There is one main reason for this erosion in coverage. Since 2003, and especially since after the crash: employers can attract and retain the kinds of employees they want without offering higher wages, training, and retirement benefits. Much of this is due to high and persistent unemployment rates. The dynamic is self feeding. Without pensions and higher wages, the fear of job loss increases, and more workers stay at their jobs despite low pay or their advancing age. This adds to more jobless and more downward pressure on wages and retirement offer rates. I am convinced of this answer because of extensive work my coauthor, Joelle Saad-Lessler and I just completed for a peer reviewed journal that showed that though workplace retirement plans (both DC and DBs) help workers save for retirement conveniently, consistently, and automatically fewer employers are sponsoring retirement accounts. Using a probit model and an Oaxaca-Blinder threefold decomposition technique applied to data from 2001 to 2012 we find that states with high unemployment and a decline in large firms create a labor-contracting environment that lowers the likelihood an employers will offer a retirement account. Therefore, attempts to raise retirement account offer rates must address the decline in workers' bargaining power and the changes in norms relating to benefits provision. An expanded Social Security system and a mandatory system that pools workers' savings into professionally managed accounts with annuitized benefits would save on tax incentives, regulations, provide insurance against the small chance of living until 92. Everyone would be covered.

Question for Dr. Ghilarducci: You state in your testimony that "no OECD, rich country outside of the United States leaves workers without a mandatory and universal system providing early and consistent retirement savings." That's a very interesting and somewhat troubling fact. Can you talk about the retirement systems of other countries? What are some of their best practices and what we can learn from these systems?

Answer

The United States, fortunately, has Social Security, a universal mandatory social insurance system. But the replacement rate is small relative to other rich nations. In the U.S. the relatively small mandatory Social Security replacement rate was intended to be supplemented by a near universal, but voluntary, and heavily tax subsidized employer system. But the coverage rates on the employer system fall flat. Expensive tax breaks and marketing campaigns do not even bring coverage rates up to 50% for all workers. Only Austria and Hungary have a system like ours that does not mandate a savings program for all workers; but, their Social Security system has much higher replacement rates. First tier mandatory social insurance provides basic income and the second tier is mandatory and links income to earnings and employment history. In most countries most second tiers are advanced funded, not pay as you go. The second tier can be publically or privately managed; in the OECD, both systems are common.

Three rich countries – Iceland, Switzerland, and the Netherlands – have systems that are suitable for the United States given the low replacement rates in Social Security. They have mandatory second tiers. NO rich country allows withdrawals of retirement savings BEFORE retirement.

Question for the Entire Panel: The problems with the current retirement system can best be summed up into two issues: access and adequacy. First, do American workers have access to a retirement plan? This is a basic question for the fifty percent of workers without plans. Second, if workers have access to a retirement plan, are their resources adequate to support them or are they at risk of out-living their savings? This second is of paramount concern to every American family. It is what keeps people up at night – will I have enough money to survive in retirement? To ensure adequacy, we need to focus on what works in the private savings market, so workers can save sufficiently. What can we do so all workers can save for retirement. How can we supplement what they currently have? Can we use SSA to get workers into supplemental plans? Are there other ways to do this more efficiently?

Answer

The Social Security administration should allow people to buy more credits from the system. This a longstanding plan and it should be implemented. In addition, the Social Security Administration should manage extra payroll savings that should be newly required of all Americans.

This plan was published in the *New York Times* in 2008, after the Financial Crises. The award is completely appropriate to the question, Senator.

December 14, 2008
8TH ANNUAL YEAR IN IDEAS
Guaranteed Retirement Account, The

By STEPHEN MIHM

"This fall, millions of Americans got a nasty shock when they opened up the reports for their individual retirement accounts and 401(k) plans. With double-digit returns a thing of the past, there's an understandable nostalgia for the modest but predictable defined-benefit pensions an earlier generation of workers relied on in retirement. Now there's a proposal that revives the idea but makes it a universal, government-sponsored program.

Teresa Ghilarducci, an economist at the New School for Social Research, has emerged as the primary exponent of "Guaranteed Retirement Accounts," or G.R.A.'s. The way they work is simple: workers who don't have access to a conventional defined-benefit plan would contribute 2.5 percent of their income (with the government seeding the first $600 of that amount). Their employers would then kick in another 2.5 percent. It's similar to a 401(k), except that the money would be deposited into an individual account with the Social Security Administration, which would pool the money and put it into relatively conservative investments.

In administering the pool, the government would guarantee a 3 percent rate of return above and beyond inflation. On retirement, participants would receive an inflation-indexed annuity that Ghilarducci calculates would replace a quarter of the wages or salary an average worker was earning. For example, someone who contributed to a G.R.A. for 40 years and retired with a final salary of $60,000 would get an annual payment of $15,500, or 26 percent of the preretirement income. (Social Security currently provides another 45 percent of workers' preretirement income.)

Like Social Security, the plan would be mandatory. Requiring workers to hand over an additional share of their income might not be popular. But Ghilarducci argues that only a program that forces people to save will prevent huge numbers of Americans from sinking into poverty during retirement. As for how to finance the new program, Ghilarducci has pointed out that reforming tax breaks for 401(k)s, which go disproportionately to high-income earners, would more than pay for the G.R.A.'s. Is such a plan plausible? "The last time the financial system was shattered," she says, "Social Security was born.""

New York Times: a version of this article appeared in print on December 14, 2008, on page MM58 of the New York edition.

Question for the Entire Panel: Social Security's benefit formula provides tiered, progressive, and modest benefits. We think about this in terms of both income and replacement rates, how much you are able to replace from the average of your highest 35 years in the workforce. We see that these benefits are extremely modest. For workers with average wages the replacement rate is 42%, for a cash benefit of $18,200 a year. For low-income workers, the replacement rate is 77%, but the cash benefit is a below-poverty amount of $8,500.

Along with Senator Harkin, I have proposed modestly increasing the benefit formula by increasing the first bend point in the Social Security formula for newly eligible beneficiaries. I would like the panel's reaction to this proposal. Is this an appropriate way to update the benefit formula?

Answer

This is a very efficient and progressive way to increase Social Security benefits for those who need it most.

Question for the Entire Panel: One of the guiding principles of Social Security is that the program works off of an insurance model. Premiums are the years that you pay payroll taxes into the system. This is important because the collective ownership and near-universal participation are part of the program's strength.

There is one important exception I would like to solicit the panel's reactions to it. Women are more likely than men to take career breaks to care for a child or another relative. And low-income workers are more likely than their better off peers to leave the paid workforce to care for a family member. Taking time off from work to raise a child or care for an ill family member should not be mistaken for a vacation. This is hard, important work and it is work that gets no credit is the Social Security benefit calculations. Given this, should Social Security include a caregiver's credit that would make sure these workers receive some credit for these years of work when calculating their Social Security benefit?

Answer

This has been a bedeviling issue for quite some time, spanning many Technical Panels for the system. The main reason is that caregiving credits for a long time benefitted higher income individuals more because mothers with husbands and high incomes could afford to take off work for care giving. The circumstances around caregiving are important and should be examined.

Question for the Entire Panel: If a beneficiary retires, dies, or becomes disabled, Social Security pays benefits to his or her children until age 18 or 19. In the past, children of beneficiaries who attended high school, college, or vocational school continued to receive benefits until age 22. Why did Congress end this benefit and do you believe it would be valuable to restore it? How much would it cost to restore?

Answer

Congress ended this benefit in the 1980s for cost reasons and that children from higher income families (relatively) were in school. However African American children were more likely to get a student benefit, and much more importantly, that income was crucial to their ability to go to college. The benefit should be restored.

Testimony of Stephen C. Goss, Chief Actuary, Social Security Administration Before the Subcommittee on Social Security, Pensions, and Family Policy of the Senate Committee on Finance

"Strengthening Social Security to Meet the Needs of Tomorrow's Retirees"

Dirksen Senate Office Building, Room 215
May 21, 2014, 10 AM

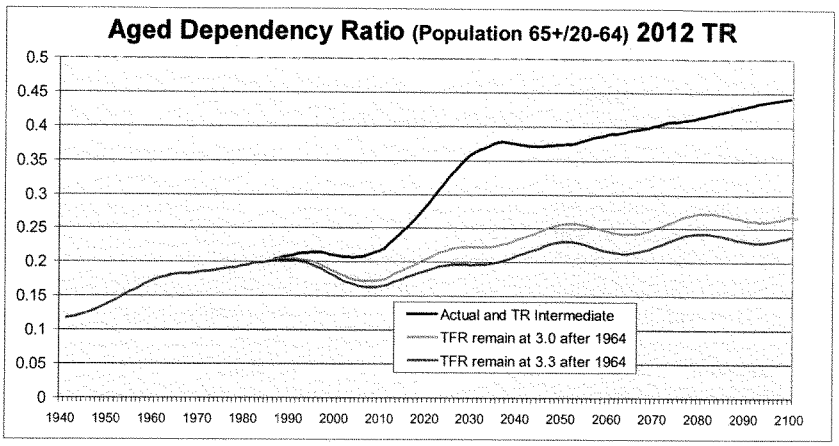
Chairman Brown, Ranking Member Toomey, and members of the Subcommittee, thank you for the opportunity to testify today on this important topic. Social Security plays a critical foundational role for the retirement income of virtually all Americans. It is often referred to as a "floor of protection" and one of the "three legs of the stool" for retirement income. However, it provides even more than that by covering insured workers and their families against loss of income in the event of disability or death. I would like to present three main points related to the future of Social Security, and indeed all sources of retirement income for the future. These are: (1) the aging of our population and the implications for the financial status of Social Security and retirement income in general, (2) the level and adequacy of monthly retirement benefits provided by Social Security, and (3) some of the changes that members of Congress and others have considered for strengthening the financial status of Social Security and the benefits it provides.

(1) The Aging of the United States Population and Implications for Retirement Income

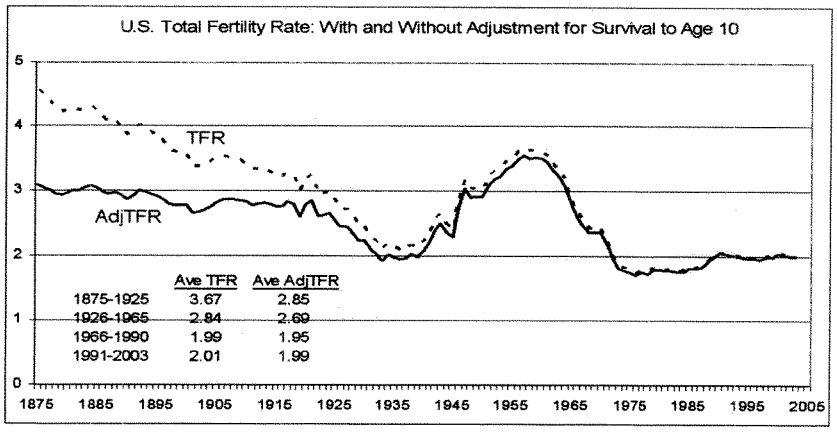
The United States and the entire world are facing dramatic population aging now and in the future. We have generally thought of the aging of the population in terms of increasing longevity resulting from declining death rates at all ages. This has been a steady and gradual process with predictable results for decades. However, there has also been a dramatic change in the "age distribution" of the U.S. population, starting with the retirement of the baby boom generation around 2008 and continuing through about 2035. This shift in the age distribution is due to the drop in the birth rate experienced after 1965. To make this point more clearly, we have started to refer to the steady, gradual increase in longevity for individuals as "***micro aging***" and the dramatic shift in the age distribution of our population as "***macro aging***."

The dramatic effects of macro aging due to the drop in birth rates after 1965 can be readily seen in the "aged-dependency" ratio, which is the ratio of people age 65 and over to the population at working ages between 20 and 64. This ratio tends to rise gradually as death rates gradually decline. However, the rise accelerated dramatically after 2010 and will continue to rise as the "baby boom" generation (those born in years 1946 through 1965) moves from working age to retirement age over the next 20 years. This shift in the aged dependency ratio is not temporary, but is a permanent level shift in the age distribution of our population. This shift will affect not only Social Security financing

but all aspects of retirement income for the future. (In the figures below, "TR" refers to the annual Social Security Trustees Report.)

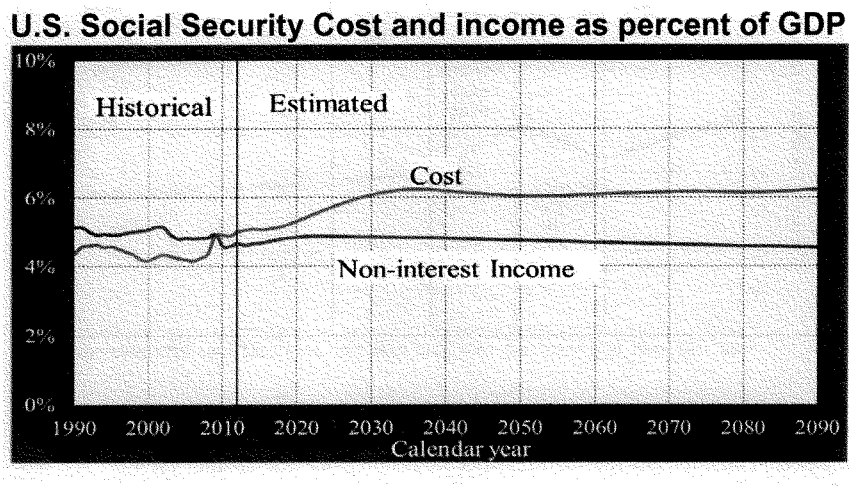


To illustrate the fact that this shift in age distribution is due to the drop in birth rates, we have developed hypothetical estimates of the aged dependency ratio assuming that the "total fertility rate" for the U.S had stayed close to the historical average of 3.0 children per woman, or had moved to the slightly elevated level of 3.3 children per woman experienced in the baby boom. If the birth rate had not dropped after 1965, the slow rise in aged dependency ratio due to gradual declines in death rates would not alone have created the macro aging effect we now face. The drop in the total fertility rate from about three children per woman before 1965 to about two children per woman since then (and projected for the future) explains the permanent level shift in the aged dependency ratio.



In the figure above, we illustrate the actual total fertility rate since 1875, as well as an "adjusted" total fertility rate where we include only births that will survive to at least age 10. Births that do not survive to age 10 will not enter the working age population and will not affect the aged dependency ratio.

The implications of macro aging for the Social Security program, and indeed for all retirement income, are direct and clear. The cost of Social Security benefits scheduled in current law rises in direct proportion to the change in the aged dependency ratio.

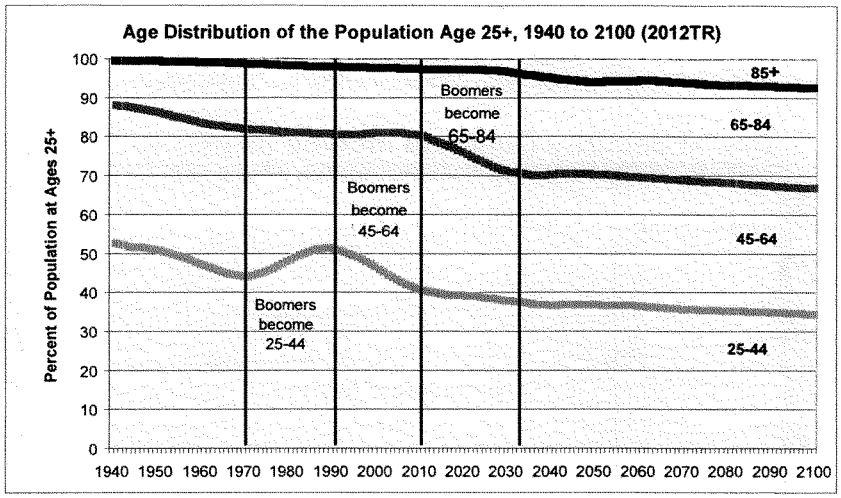


The challenge before us in strengthening the actuarial status of the Social Security program is due to macro aging. This realization will hopefully help guide lawmakers in selecting adjustments to the program's income and outgo for the future that are appropriate and serve the needs of all Americans.

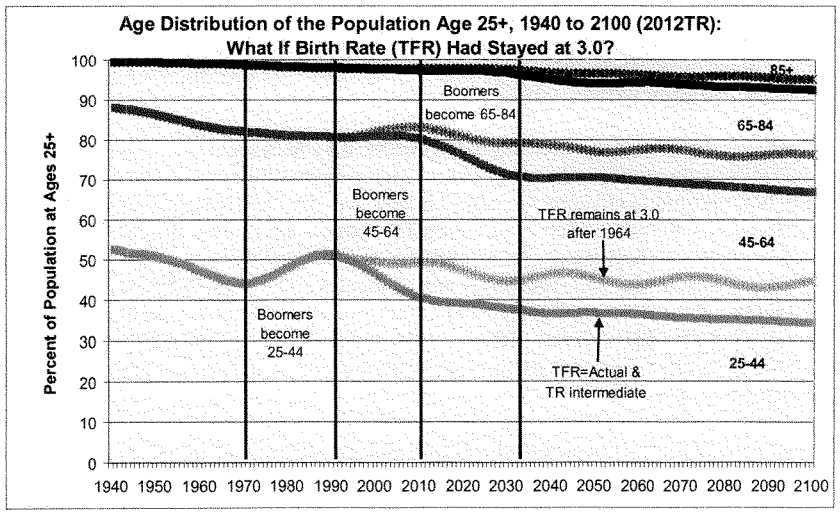
The macro aging effect for retirement costs illustrated by the aged dependency ratio is just one dimension of the macro aging effect. Marco aging of the age distribution has already had a profound effect on the cost of Social Security Disability Insurance (DI) benefits. DI benefits are available until normal retirement age (currently age 66) for insured workers who become unable to work due to a medically determinable impairment. The baby boom generation moved into young adult ages 25 through 44 between 1970 and 1990, increasing the number of people in the workforce much more than they increased the numbers of disabled workers. Between 1990 and 2010, the reverse occurred as the baby boom generation then moved into ages 45 through 64, which are the principal disability-prone ages.

The figure below shows the historical and projected age distribution of the adult population and illustrates the dramatic effects of the movement of the baby boom generation over time. This dramatic effect would, of course, not be as notable or

important if the birth rate had not dropped so precipitously after 1965. In fact, if the birth rate had not dropped, the baby boom generation would not be extraordinarily large in relation to the following generations.



As a hypothetical illustration of the impact of the drop in birth rates after 1965, the figure below shows how different the age distribution of the U.S. population would have been if the overall total fertility rate had stayed at 3.0 children per woman after 1964.



As with the aged dependency ratio, we see that the change in the adult age distribution (macro aging) would have been far more gradual and less severe if birth rates had not dropped to a permanently lower level after 1964.

(2) Level and Adequacy of Monthly Social Security Retirement Benefits

Social Security benefits have always been intended to provide a floor of protection for retirees, as well as for disabled workers and the families of deceased workers. Employer-provided pensions and personal savings complete the "three legged stool" for retirement income. Traditionally, many employer-sponsored pension plans provided a "defined benefit" in the form of a monthly annuity for life that complemented the life annuity provided by Social Security.

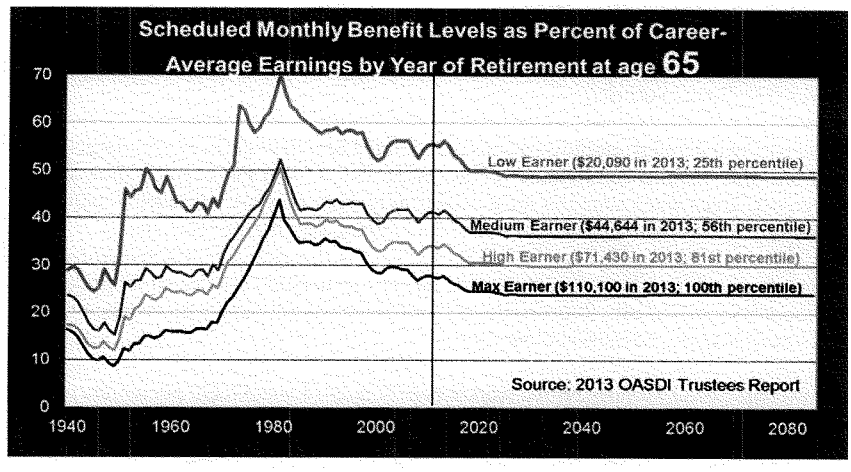
In the past two decades, employer-sponsored defined benefit plans have been largely replaced with "defined contribution" plans that provide a lump sum accumulation at retirement. Even when annuities are available to retirees, they are infrequently purchased. Moreover, increasing numbers of defined benefit plans are offering lump sum distributions. This trend has left Social Security as the sole source of lifetime retirement income for most Americans, and in general the only source that is adjusted for price increases after retirement. Retirees are increasingly at risk for having no income other than Social Security benefits at older ages.

The average Social Security retired worker benefit in 2013 was $1,270 per month, or about $15,240 if received for a full year. Average earnings for workers in the U.S. were about $44,000 in 2013. Thus, benefits represented about 35 percent of the level of average earnings.

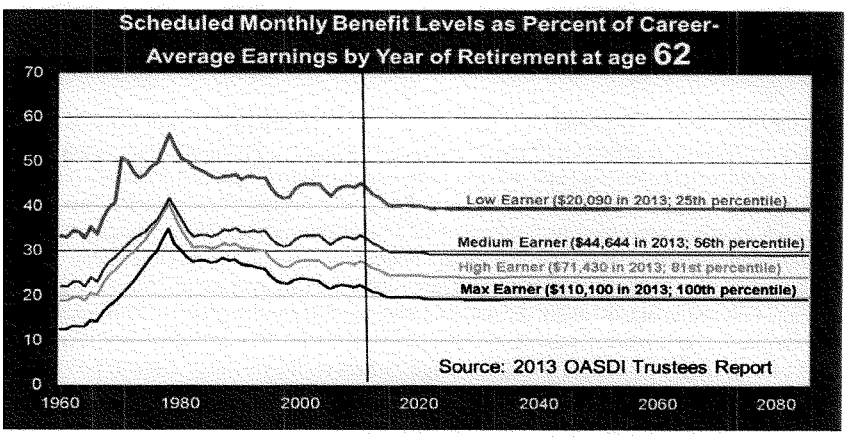
Of course, Social Security benefits are based only on earnings subject to the payroll tax, which was a little over 82 percent of total earnings for covered workers in 2013. This means that the average retired worker benefit is about 42 percent of the average taxable earnings of workers in 2013. This is well below the target level that workers generally want in retirement, again suggesting the importance of other sources of retirement income.

A fuller illustration of the level and adequacy of Social Security retirement benefits can be seen by looking at retirement benefit "replacement rates." Traditionally, a target benefit replacement rate has been thought to be around 70 to 80 percent of late-career or final pay for a steady, long-career employee. For Social Security beneficiaries, this approach of using late-career or final pay would be inappropriate. The earnings patterns of American workers across their careers are extremely varied. The level of Social Security retirement benefits under current law is based on an average of 35 years of earnings indexed to age 60 using the national average wage index (AWI). This approach puts earnings over a worker's career on an equivalent basis to the average wage level, that is, the average standard of living for wage earners in the year the retiree turned 60. This approach approximates the late-career earnings level of steady career earners toward the end of their careers.

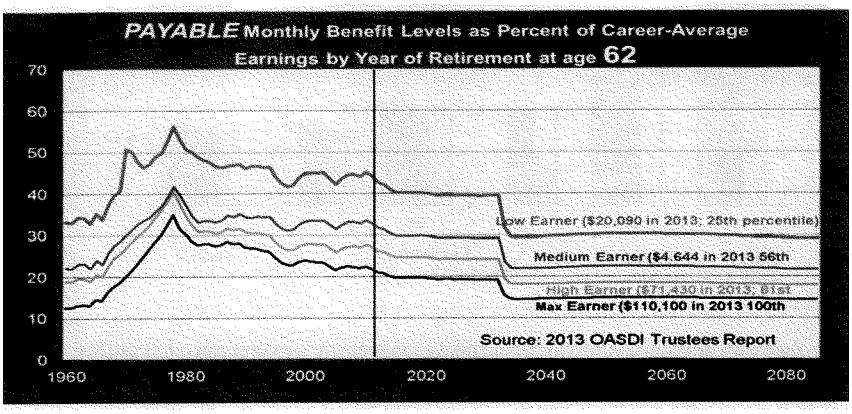
The figure below illustrates the benefit replacement rate for hypothetical workers retiring at age 65 with various career-average earnings levels. The replacement rate here compares the benefit in the first full year of retirement to the high 35 years average earnings indexed by the AWI to the year before retirement. Future retirees starting benefits at age 65 will have a replacement rate of about 50 percent at the 25th percentile of earners, about 40 percent for the 56th percentile of earners, and about 30 percent for workers at the 81st percentile of career-average earnings.



However, the largest portion of Social Security retirees (about half) start benefits at age 62. Benefit replacement rates are far lower for benefits starting at age 62 due to the actuarial reduction factors for early retirement.



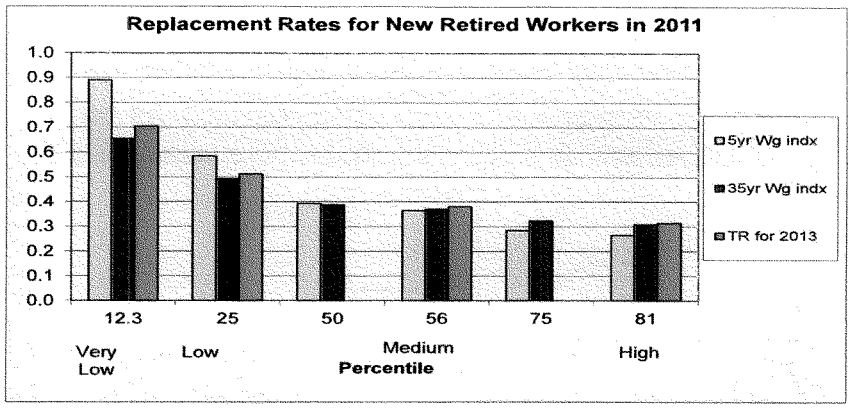
Given the financial shortfall facing Social Security by 2033, the level of benefits payable to retirees will drop by about 25 percent in 2033 if no legislative action is taken before then.



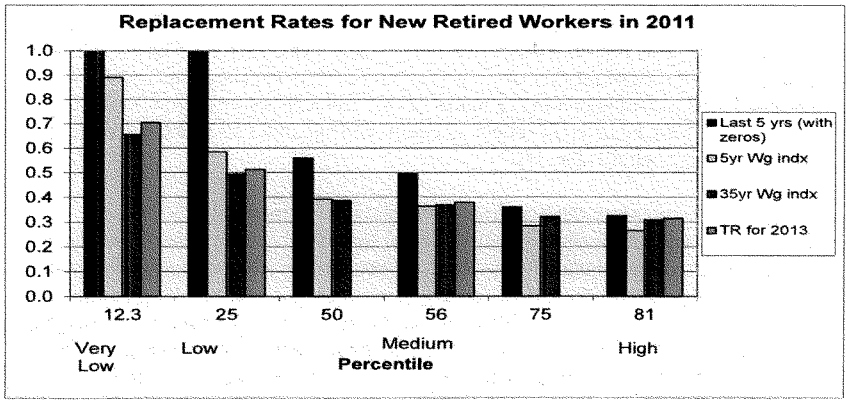
The benefit replacement rates illustrated above are consistent with the underlying approach for determining benefits under current law, and are also consistent with the approach used by the OECD in evaluating benefit levels for social insurance plans in economically developed nations. The OECD recognizes that in the general economy, earnings patterns for individual workers vary widely. The approach of using long career average earnings, indexed to the year before starting benefits, is qualitatively equivalent to using late-career or final pay for long-career steady workers. However, this is not the only plausible approach to developing benefit replacement rates for social insurance.

In order to explore the implications of other earnings concepts on benefit replacement rates, the Office of the Chief Actuary has analyzed a 10 percent sample of all new retired workers in 2011. This is a sample of over 200,000 new beneficiaries. The average age at the start of benefit receipt for this group was about 63.75 years, about halfway between 62 and 65. For the comparison in the figure below, replacement rates from the 2013 Trustees Report were adjusted to reflect a benefit start age of 63.75 years, consistent with the sample average benefit start age.

The figure below compares the benefit replacement rates consistent with those for hypothetical scaled workers from the 2013 Social Security Trustees Report (blue bars) to the replacement-rate distributions from the 2011 new beneficiaries using two different concepts. The red bars for the 2011 new beneficiaries show benefit replacement rates relative to the high 35 years of earnings indexed to the year before benefits start using the AWI. It is not surprising that replacement rates under this approach are very close to those from the Trustees Report, adjusted for equivalent average age at benefit start.



The gray bars provide a further replacement rate concept for comparison. For this approach, we selected the last six years of non-zero earnings prior to benefit start and dropped the last such year (because generally the last year of earnings before retirement will include only earnings for a half year). The selected years are indexed to the year prior to benefit start by the AWI, because many of these years are well before the benefit start age. At the median of the distribution, this approach to developing replacement rates provides values extremely close to both those for the 35-year career average for 2011 new beneficiaries, and those from the Trustees Report for hypothetical scaled workers. For other than the median earnings level, the gray bars demonstrate a wider divergence than shown for the median replacement rate, because average earnings levels over just five years prior to retirement are more varied than career average earnings over 35 years.



For a further comparison, we computed the benefit replacement rates for the 2011 new beneficiaries using the average of earnings in the last five calendar years immediately

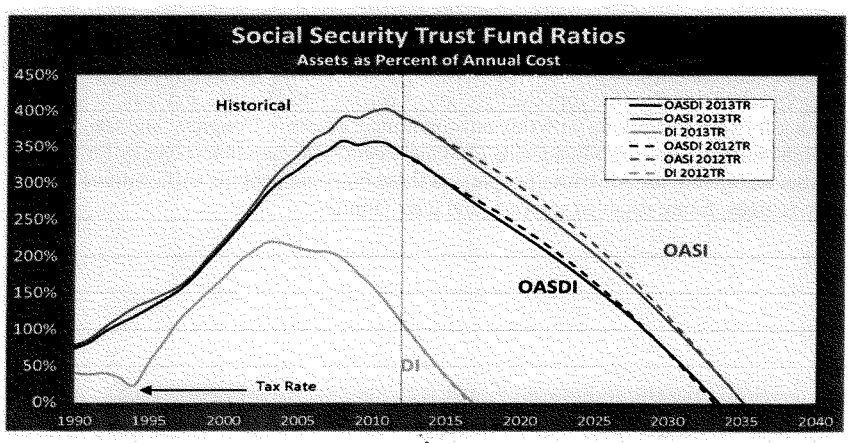
prior to benefit start, including years of zero or very low earnings. These values are shown in the maroon bars in the figure above. This approach is flawed as a proxy for the benefit replacement as a percent of actual earnings, because 25 percent of years in the last five before benefit start had zero earnings. In addition, about 15 percent of the new beneficiaries had no earnings at all in the five years before starting benefits. Given this, it is not surprising to see that replacement rates computed in this way are considerably higher than those computed using the other approaches.

Overall, we see that at the median, benefits scheduled under current law provide roughly 40 percent of the 35-year career average and 5-year late-career average earnings levels. This is comparable to the ratio of the average annual benefit for retired workers to the average of taxable earnings in the same year.

If workers desire to have lifetime retirement income of 70 to 80 percent of earnings during their career, or near retirement, then they need to save more and purchase more life annuities. While career earners at the 12th percentile may have Social Security benefits as high as 70 percent of career average earnings, such individuals tend to be far more dependent on Social Security as a sole source of retirement income. About one-third of Social Security beneficiaries have little if any income outside of that provided by Social Security.

(3) Potential Changes for Strengthening Social Security Financial Status and Benefit Adequacy

The Social Security program operates under the financing provided from two distinct trust funds, one for Old Age and Survivors Insurance (OASI) benefits and the other for Disability Insurance (DI) benefits. The trust fund reserves for the DI program are projected to become depleted late in 2016, so legislative action is needed soon. One approach would be a temporary reallocation of a portion of the payroll tax rate (total 12.4 percent) between the OASI and DI Trust Funds. Even with this reallocation, one or both of the reserves are projected to become depleted by 2033.



In order to avert depletion of trust fund reserves, changes will be necessary to (1) reduce scheduled benefit levels by about 25 percent, (2) increase scheduled revenue by about 33 percent, or (3) make some combination of these changes.

A wide variety of possible changes to the Social Security Act have been considered by members of the Congress and other policymakers. The Office of the Chief Actuary has developed estimates for many dozens of possible changes in both scheduled benefits and scheduled revenue. Our estimates provided to the sponsors of these proposals can be found at http://www.ssa.gov/oact/ at the links "Proposals" and "Provisions".

In addition, many potential changes have been proposed and evaluated that would be intended to enhance, strengthen, or increase benefits for specific groups of beneficiaries. Such proposals include restoration of student benefits, increase of the special minimum benefit, increase in aged surviving spouse benefits, and use of the CPI-E (based on purchase patterns by persons age 62 and older) instead of the CPI-W (based on purchases of urban wage earners.)

Conclusion

Social Security benefits continue to be the primary "floor of protection" for Americans in retirement, for those disabled, and for the surviving family members of workers when they die. Because of the reduced birth rates after 1965, the U.S. is entering a period of dramatic macro aging that has already affected the cost of the DI program over the past 20 years.

Changes are needed soon to avert trust fund reserve depletion and an abrupt reduction in the level of benefits payable with scheduled income. The Congress, on behalf of the American people, will need to decide whether to (1) maintain currently scheduled benefit levels, which would require increasing program revenue from 4.5 to 6 percent of GDP, (2) reduce scheduled benefits by 25 percent, or (3) implement some combination of these options.

Many options for reducing benefits and/or increasing revenue have been considered by members of Congress and have been scored by the Office of the Chief Actuary. In addition, many proposals have been developed that would enhance and strengthen currently scheduled benefits for select groups of worker beneficiaries and their families. We look forward to working with this Subcommittee, others in Congress, and the Administration to develop adjustments to Social Security to maintain solvency for the program and assure the American people that these essential benefits will continue for future retirees, future disabled workers, and their families.

Responses to Questions for the Record From Stephen Goss
Senate Finance Committee Hearing of May 21, 2014

Questions From Senator Brown

Question for Dr. Ghilarducci and Mr. Goss: Everyone on this panel and on this committee can agree that the Financial Crisis and subsequent recession did enormous damage to the American economy and working family's retirement savings. Now, five years later, the economy is slowly healing but the stock market and corporate profits are at all-time highs. This has not translated to a dramatic improvement in the retirement picture. What is going wrong and why is there a disconnect between the stock market and private retirement accounts?

Goss: Private retirement accounts benefit from investment in the stock market over the long term because equity yields exceed the yield on less volatile bond investments. However, accumulated retirement accounts also reflect the degree workers save in these accounts and leave funds in the accounts for retirement. In times of significant economic downturn, many workers will reduce or cease saving temporarily, or withdraw funds or take out loans against the account balance. Withdrawals and loans are particularly likely when unemployment rates rise. The fact that many retirement accounts permit withdrawals before retirement and the IRS waives penalties for certain limited hardship situations means that many workers with low or moderate earnings levels will ultimately accumulate less toward retirement than they had intended.

Question for the Entire Panel: The problems with the current retirement system can best be summed up into two issues: access and adequacy. First, do American workers have access to a retirement plan? This is a basic question for the fifty percent of workers without plans. Second, if workers have access to a retirement plan, are their resources adequate to support them or are they at risk of out-living their savings?

This second is of paramount concern to every American family. It is what keeps people up at night – will I have enough money to survive in retirement? To ensure adequacy, we need to focus on what works in the private savings market, so workers can save sufficiently.

What can we do so all workers can save for retirement. How can we supplement what they currently have? Can we use SSA to get workers into supplemental plans? Are there other ways to do this more efficiently?

Goss: Generally speaking, Americans do have access to savings accounts in which they can save for retirement. However, the likelihood of saving is enhanced by the availability of an employer match or a tax preference as provided by employer sponsored plans. The largest hindrance to broad saving by workers is their need for current consumption that leaves little or nothing that they can or are willing to save. To the second point, Social Security is the only universal savings plan that requires a life annuity for distribution of earned benefits. Defined contribution plans and even some defined benefit plans offer "lump-sum" distribution options at retirement and relatively few retirees purchase life annuities with these proceeds. In essence, we have

succeeded fairly well in encouraging workers to save to build a "nest egg," but we have failed in encouraging workers to use their accumulation to provide income for the rest of their life through the purchase of a life annuity. The most accessible and favorably priced life annuity for workers is achieved by delaying the start of Social Security retirement benefits for some years after initial eligibility. For example, delaying the start Social Security retirement benefits by one year increases the size of the monthly life annuity by over 6 percent. However, delaying the start of Social Security benefits or the purchase of a commercial life annuity is not possible for individuals who cannot work past age 62 and have no substantial retirement savings outside Social Security. In order to enhance retirement income adequacy, we must encourage workers not only to save more before retirement, but also to use their savings or their ability to continue working to either (1) delay the starting age for Social Security benefits or (2) purchase a commercial life annuity.

Question for the Entire Panel: Social Security's benefit formula provides tiered, progressive, and modest benefits. We think about this in terms of both income and replacement rates, how much you are able to replace from the average of your highest 35 years in the workforce. We see that these benefits are extremely modest. For workers with average wages the replacement rate is 42%, for a cash benefit of $18,200 a year. For low-income workers, the replacement rate is 77%, but the cash benefit is a below-poverty amount of $8,500.

Along with Senator Harkin, I have proposed modestly increasing the benefit formula by increasing the first bend point in the Social Security formula for newly eligible beneficiaries. I would like the panel's reaction to this proposal. Is this an appropriate way to update the benefit formula?

Goss: The Social Security benefit formula is designed to maintain benefit replacement rates at the same level across generations. Specifically, the benefit replacement rate for retirees with career average earnings at any given percentage of the national average wage index (AWI) will be the same across generations, with one caveat. When the normal retirement age (65 until 2000, 66 currently, and 67 by 2022) increases by a year, workers must delay the start of benefits by a year in order to maintain the same replacement rate as prior generations with the same relative earnings. If the generation with a one-year higher normal retirement age does not start benefits later, then they will receive monthly benefits that are more than 6 percent lower than prior generations.

The proposal that Senators Harkin and Brown have put forth would ultimately increase the first primary insurance amount (PIA) bend point by 15 percent. About 90 percent of retirees have career average indexed earnings above this first bend point, so their monthly retirement income would be increased under the proposal. If this change were fully in effect today, then all workers age 62 this year, with a career average indexed monthly earnings level of about $940 or more, would have a PIA that is about $70 per month higher than under current law. Of course, no increase in benefit level is possible unless the revenue to finance it is generated. The Bill introduced by Senator Harkin also raises payroll taxes by more than enough to finance this benefit increase.

Question for the Entire Panel: One of the guiding principles of Social Security is that the program works off of an insurance model. Premiums are the years that you pay payroll taxes into the system. This is important because the collective ownership and near-universal participation are part of the program's strength.

There is one important exception I would like to solicit the panel's reactions to it. Women are more likely than men to take career breaks to care for a child or another relative. And low-income workers are more likely than their better off peers to leave the paid workforce to care for a family member. Taking time off from work to raise a child or care for an ill family member should not be mistaken for a vacation. This is hard, important work and it is work that gets no credit is the Social Security benefit calculations. Given this, should Social Security include a caregivers credit that would make sure these workers receive some credit for these years of work when calculating their Social Security benefit?

Goss: One important consideration is that Social Security is not purely an insurance program. Arguably, disability and survivor benefits represent insurance against becoming unable to work or dying prior to reaching retirement age. On the other hand, retirement benefits may be viewed as a "savings" mechanism to a degree. All who survive past retirement age will be able to receive a benefit based on their prior taxable earnings. However, there is an insurance aspect of retirement benefits under Social Security, which is extremely important. Rather than offering a fixed lump sum distribution at retirement age, Social Security provides benefits only in the form of a CPI-indexed life annuity, which guarantees a benefit for as long as each beneficiary lives. This "insurance" against the risk of living a longer than average life can only be provided by a life annuity such as that provided by Social Security.

Regarding "credit" under the Social Security benefit formula for years any worker suspended earnings to care for a child or an elder person, only a relatively small assistance is currently provided. The weighted benefit formula results in a percentage reduction in PIA that is smaller than the percentage reduction in the career average earnings level caused by suspending earnings for one or more years. Only for disabled workers at young ages does the Social Security program now provide specific credit for years the worker suspended work to care for a young child. Some policymakers have developed proposals to credit an amount of earnings, or to reduce the number of years used in computing the career-average earnings level, for some number of years when the worker suspended work to care for a child or elder person. If these proposals provide a small financial incentive to have a child and, thus, increase the birth rate, a positive effect on the long-range financial status of Social Security would result, which would partially offset the cost of providing this incentive.

Question for the Entire Panel: If a beneficiary retires, dies, or becomes disabled, Social Security pays benefits to his or her children until age 18 or 19. In the past, children of beneficiaries who attended high school, college, or vocational school continued to receive benefits until age 22. Why did Congress end this benefit and do you believe it would be valuable to restore it? How much would it cost to restore?

Goss: Currently, benefits are available to full-time students who are children of retired, deceased, or disabled workers up to their attainment of age of 18. Benefits may be continued for these

children over age 18 and up to age 19 if they are attending an elementary or secondary level school.

Extending benefit eligibility for all full-time students up to attainment of age 22 (including college and vocational school students) would increase OASDI cost over the long-range 75-year period by about 0.07 percent of taxable payroll. If this extension were implemented fully this year, the added cost for the year would be between $4 and $5 billion.

Question for Mr. Goss: We heard some very compelling testimony from Mr. Goss on the rapidly aging population. This highlights one particularly vulnerable group – the very old. Poverty rates for men over 80 exceed any other senior group. The poverty rate for women over 80 is 5 percentage points higher than it is for other populations.

How can we strengthen Social Security to reduce poverty among the very old?

Goss: This is an extremely good question and a very important issue. Far too many workers spend down whatever savings they have accumulated soon after retirement, often due to unexpected medical expenses. Thus, our very old retirees tend to become increasingly dependent on Social Security for most, if not all, of their income. For this reason, the annual cost-of-living adjustment that reflects price increases faced by urban wage earners (CPI-W) is not enough to maintain the same standard of living for very old beneficiaries that they enjoyed earlier in their retirement. Proposals that would help reduce this erosion in the standard of living as retirees become very old include (1) a "bump" in benefit levels around age 86, and (2) a larger annual cost-of-living adjustment to Social Security benefits, accomplished by basing the adjustment on the CPI for the elderly (CPI-E) rather than the CPI-W. The CPI-E generally rises faster because consumer expenditures by the elderly include a higher proportion of medical expenses, which tend to grow more rapidly than non-medical expenses.

STATEMENT OF MAYA ROCKEYMOORE, PH.D.

BEFORE THE SENATE FINANCE COMMITTEE, SUBCOMMITTEE ON SOCIAL SECURITY, PENSIONS, AND FAMILY POLICY

Wednesday, May 21, 2014

"How Structural Factors Drive the Need to Expand Social Security Benefits for Future Retirees"

Good morning Committee Chairman Brown, Ranking Member Toomey and members of the United States Committee on Finance, Subcommittee on Social Security, Pensions and Family Policy. Thank you for inviting me to speak to you today on a matter of critical importance for the future of our children, our workforce and our nation.

Mr. Chairman, I request that the entirety of my written testimony be entered into the record of the hearing.

My name is Maya Rockeymoore, I am President of the Center for Global Policy Solutions, a nonprofit think and action tank dedicated to making policy work for people and their environments. I hold a Ph.D. in political science with a specialty in public policy and have been a practicing policy analyst and researcher in DC for almost 20 years. A former professional staffer on the House Ways and Means Social Security Subcommittee, I currently chair the board of the National Committee to Preserve Social Security and Medicare, serve as co-chair of the Commission to Modernize Social Security, and serve on the boards of the National Academy of Social Insurance, Economic Policy Institute, and the National Association of Counties Financial Services Corporation.

WHY SOCIAL SECURITY IS IMPORTANT

Mr. Chairman, I am testifying this morning on the importance of strengthening Social Security for tomorrow's retirees—a group that includes today's youth. While a seemingly obvious fact, this is an important point precisely because some have argued in recent years that Social Security investments in retirees have undermined critical investments in our children. Nothing could be further from the truth. It is important to remember that Social Security serves people at all stages of the life cycle—from birth to death. More than 4.4 million children receive Social Security benefits as the dependents of deceased, disabled, and retired workers (Social Security Administration, 2013). But Social Security's importance to our youth must also be viewed from another critical perspective.

You see, what the title of this hearing makes clear and what we should all understand is that today's young will become tomorrow's old. And, given what we know about the material weaknesses in our economy, the structural inefficiencies of our labor market, the deficiencies of employer-sponsored retirement options, and the likely socioeconomic effects of projected demographic changes, our children will need Social Security for their own retirement as much, if not more so, than their parents did. For this reason, it is important to understand that Social Security is a societal investment that is as vital for tomorrow's retirees as it is for todays.

There are a number of reasons why Social Security will be of continued importance for tomorrow's retirees. The first is the well-documented retirement crisis that has gotten progressively worse over the past few decades. Nearly half (57%) of private sector workers do not have access to a tax preferred, employer-sponsored retirement savings plan of any kind (Rhee, 2013). Of private sector workers who do have access and participate in a retirement plan, a substantial majority (69%) had only a defined contribution, or 401k-style, plan while a diminishing few (7%) had access to only a defined benefit, or traditional pension, plan (Employee Benefit Research Institute, 2011).

There have been numerous studies warning of the significant deficiencies of 401k retirement accounts, which have become the staple of private sector retirement plans. Among the many challenges is that they leave most account holders without enough resources to maintain their desired standard of living in retirement. Of those with retirement accounts, the median account balance was a paltry $40,000 in 2010; suggesting that even those with accounts have few retirement savings (Rhee, 2013). This is especially true of older workers nearing retirement, whose median 401k account balance was $120,000 in 2010, barely enough to provide a modest supplement to the Social Security benefits that they will continue to need in retirement (Munnell, 2012).

Despite known problems with 401ks, there are growing calls for public sector employers to offset their pension liabilities by following the private sector's lead in turning to defined contribution plans, which shifts greater financial risks to employees. A number of states are pursuing this objective by adopting hybrid models and a few—Oklahoma being the most recent—are seriously considering adopting a defined contribution only retirement plan for their workers. If more states and localities move in this direction, there will be a retirement security crisis of epic proportions for public sector workers who have traditionally enjoyed more secure retirement benefits. This could increase future pressure on the Social Security system, possibly by increasing calls to include more state and local workers within its benefit structure.

Furthermore, there are structural inequalities in our labor market that shut millions of workers out of non-Social Security retirement savings. Currently, 38 million working age households (45% of the US workforce) do not have retirement account savings of any kind (Rhee, 2013). The biggest reason for this gap is that access to

employer-sponsored retirement accounts varies by industry sector, occupation, size of employer, and whether the job has union coverage (Hiltonsmith, 2010). When these factors are layered on top of structural inequalities in the U.S. labor market such as occupational segregation and pay disparities by race, class, gender, and education, we begin to understand why access to private retirement accounts correlates strongly with high wage and "white collar" employment and why already economically disadvantaged groups—such as the young, people of color, and low-income workers—are the least likely to have any other form of retirement savings outside of Social Security (Hiltonsmith, 2010).

A third reason pointing to Social Security's continued relevance for future retirees is the generational impact that the Great Recession has had on earnings potential for younger workers. It has long been understood that in vibrant economies, children typically fare better in terms of wealth accumulation then their parents did at similar ages; but in the U.S. this no longer holds true for Generation X and Y who have accumulated less wealth than their parents did at that age (Steuerle, 2013). Referred to as the "lost generation," today's young adults have dealt with high unemployment rates, demoralizing under employment, and lower wages. From 2007 to 2010, it is estimated that Generation Xers lost 45 percent of their wealth, reducing their already low wealth levels by almost half (Gist, 2013). All of these factors translate into fewer opportunities to save for retirement, which means young adults in these cohorts will not have enough assets accumulated to achieve economic security in retirement (Gist, 2013). Given the depression-era unemployment levels among teens in recent years, there remains serious cause for concern about the retirement prospects for America's youngest workers as well (Ayres, 2013).

The nations shifting demographics represent the fourth reason why Social Security will continue to be important for future retirees. There are two phenomena associated with the projected demographic shifts. First is the ongoing retirement of the baby boomer generation, with the number of older Americans expected to increase from 46.6 million today to over 77 million by the year 2033 (Social Security Administration, 2014). It is clear that with older adults becoming a larger percentage of the U.S. population, the value and strength of Social Security will remain a top priority for the nation for decades to come.

The second, and often overlooked shift, relates to race and ethnicity. U.S. Census figures show that today a majority of babies born in the U.S. are from non-white racial and ethnic groups, by 2019 a majority of children and youth under the age of 18 will be from non-white households; and by 2042 the majority of the U.S. population will be non-white. This is significant because households of color are more likely to be heavily reliant on Social Security for most or all of the retirement income (Rockeymoore, 2011).

While it is often assumed that our nation is proceeding, albeit slowly, toward a diverse and inclusive economy, in fact, the racial and ethnic wealth gap has risen

fourfold over the past several decades (Shapiro, 2010). And the depth of this gap, driven by differentials in homeownership, income, education, unemployment, and inherited wealth, is deep (Shapiro T. M., 2013). A newly released report by the Center for Global Policy Solutions and the Research Network on Racial and Ethnic Inequality at Duke University found that for every dollar of wealth held by the typical white family, the typical African American and Latino families only own six and seven cents of wealth respectively (Tippet, 2014). Furthermore, the study finds that over a third of African Americans (38%) and Latinos (35%) have no financial assets whatsoever compared to only 14 percent of whites and that less than a third of African Americans (32%) and Latinos (28%) possess retirement accounts compared to 58 percent of whites (Tippet, 2014).

It is important to note that the growth of the Latino population is the largest driver of the ongoing ethnic demographic shift, but less than four out of ten (37.8%) Latinos have access to employer-sponsored retirement plans, compared to 62.3 percent of whites (Rhee, 2013). Of those with a plan, 4 out of 5 Latino households age 25-64 have less than $10K in retirement savings suggesting that Social Security will remain a vital component of their retirement income (Rhee, 2013).

EXPANDING SOCIAL SECURITY

The structural challenges driving our nation's retirement crisis means that, absent comprehensive and equitable policy reforms, a majority of the nation's workers will continue to rely on Social Security for much of their retirement income well into the future. Yet, despite Social Security's role in serving as a critical retirement resource for U.S. workers, its benefits remain modest. Today's average monthly benefit for retired workers is $1,294, or only $15,528 per year (Social Security Administration, 2014). This amount is above the official poverty guideline for a single person living alone ($11,670 in 2014) but below more up to date measures of poverty that account for health care, housing, and other expenses born by the elderly (Reno, 2009).

For this reason, efforts to strengthen Social Security should not only focus on the program's solvency, they must also consider how to increase the adequacy of benefits for vulnerable populations, and how to modernize the program to meet changing population needs. In recognition of this need, a growing number of experts, policymakers and advocacy organizations are calling for the expansion of Social Security, the only near-universal, portable, and affordable retirement vehicle accessible to most of America's working-age population.

Generally, efforts to strengthen and expand Social Security include three different types of proposals: 1) strengthening benefits for vulnerable groups; 2) extending or restoring benefits to new groups; and, 3) adding new program elements to Social Security's social insurance framework.

Strengthening Benefits for Vulnerable Populations

There are a number of population groups for whom Social Security is extremely important, but for a variety of reasons the program's benefits are often not sufficient to survive and thrive. Without other sources of support to turn to, groups such as the very old, very poor, newly disabled, unemployed caregivers, children, and widows are among the populations for whom more adequate Social Security benefits would make dramatic improvements in their quality of life. Popular proposals to strengthen the adequacy of Social Security benefits for vulnerable groups include:

- Increasing benefits for the very old. Those in advanced years of age are susceptible to extreme poverty because they have outlived other resources, are unable to work, or have seen the value of assets they may have eroded by inflation (Reno, 2009). This group tends to be disproportionately comprised of women who have longer life expectancies than men. To improve outcomes, proposals for this group include boosting benefits by a uniform dollar amount or by five percent for beneficiaries age 85 and older. The first option would give everyone the same amount of support but the second option would make an increase dependent upon the level of benefits received (Reno, 2009).
- Increasing benefits for widowed spouses. Widowed spouses tend to be economically insecure in retirement because the pension support that their spouse may have received either ends or declines sharply upon his or her death or because both spouses worked at low pay during their working years thereby resulting in no boost in benefits for widowed spouses (Reno, 2009). Proposals to strengthen benefits for widowed spouses include increasing benefits for the surviving spouse to 75 percent of the sum of worker benefits received by the couple with either a cap to not exceed the average earnings of one person (which targets the benefit to the surviving spouse of dual-earning, low-income couples) or a cap to not exceed the maximum earnings of one person that is taxed and counted for Social Security purposes (which targets the benefit to the surviving spouse of a higher earning worker) (Reno, 2009).
- Increasing benefits for the very low income. Retirees who have previously worked for many years at low wages are very vulnerable to poverty because they are the most likely to have worked in sectors that do not provide private pensions and often do not have the disposable income to save on their own, thereby increasing their risk of economic insecurity in retirement. In 1974, a special minimum benefit was added to Social Security but today few receive it because it was not designed to keep up with wage growth (Reno, 2009). Proposals to strengthen benefits for retirees who have worked for low wages for at least thirty years include updating the special minimum benefit to 125 percent of the current poverty threshold and increasing benefits for single retirees at retirement and/or upon reaching the age of 85 (Reno, 2009).

- Providing across-the-board benefit increases for all beneficiaries. Stagnating wages and the effects of the Great Recession have imposed financial hardship on all workers but have had an especially detrimental affect on vulnerable workers—particularly younger adults, low-income workers, and workers of color—whom experts predict will never make up the earnings they lost due to unemployment and underemployment (Steuerle, 2013) (Tippet, 2014). As a result, many suggest that Social Security's modest benefits need to be increased across the board to meet the projected income needs of future retirees who have been harmed by macroeconomic factors beyond their control (Reno, 2009) (Tippet, 2014).
- Adopting a better cost-of-living-adjustment (COLA) measure. The purpose of the COLA is to ensure that the value of Social Security benefits keep pace with increases in inflation so that seniors can maintain their purchasing power. However, the CPI-W, the measure historically used to calculate the adjustments, does not account for the added costs that older adults bear, particularly in the area of health care expenses. The Bureau of Labor Statistics has maintained an alternative measure of inflation, the CPI-E, since 1987. This measure includes the purchasing patterns of America's seniors and has historically reflected a rate of inflation 0.2 to 0.3 percentage points higher than the rate generated by the CPI-W. Proposals to strengthen Social Security call for adopting the CPI-E for the purposes of determining annual COLA adjustments for Social Security recipients (Estes, 2012).

Extending or Restoring Benefits to New Groups

A number of proposals to strengthen Social Security focus on how to extend or restore benefits to new population groups who are economically vulnerable without the program's coverage. Prominent proposals within this category of expansion include:

- Extending benefits to caregivers. Caregivers, who are disproportionately women, are disadvantaged by the Social Security benefit formula when they are forced to work part-time or take time out of the formal economy to care for dependent children or relatives. These years of part time work or formal unemployment reduce the benefits of caregivers upon retirement and, for women especially who also experience lifetime pay disparities and live longer than men, make them especially vulnerable to poverty. Proposals to strengthen Social Security for caregivers include establishing a family service credit, for up to five total service years, with imputed earnings equal to one half of that year's average annual wage. Eligible beneficiaries would have to demonstrate that any earnings received in their family service year(s) amounted to less than 50 percent of that year's average annual wage. Imputed earnings would be used to close the gap between actual earnings and the 50 percent of average annual wage threshold (Estes, 2012).
- Covering immigrant workers. Undocumented immigrants working in the U.S. are currently not eligible to receive Social Security benefits even though many contribute to its trust funds and experts widely acknowledge that

comprehensive immigration reform could improve the program's actuarial balance over time (Miranda, 2010). Lack of Social Security or private pension coverage, combined with a lifetime of low-wage work, increases the extreme financially vulnerable of immigrant workers as they age. Expanding the number of legal immigrants through comprehensive immigration reform would not only provide a pathway for immigrants to access Social Security benefits, it would strengthen Social Security's financing mechanism by improving the worker to retiree ratio (Miranda, 2010).

- Restoring the student benefit. Currently, children with a disabled or deceased parent are eligible to receive Social Security benefits up to the age of 18 or 19 if still in high school. Prior to 1981, when the program was ended, these young people were able to keep receiving benefits up until the age of 22 as long as they were enrolled in college, vocational school or high school. Research shows that the additional years of income helped many low-income students receive a college education. Studies show that a college degree tends to enhance earnings over a lifetime, which, in turn, strengthens Social Security benefits upon retirement. Restoring the student benefit could have a directly positive benefit on financial outcomes for future retirees.
- Covering same-sex couples. Although blanket discrimination against providing Social Security benefits to same-sex couples ended when the U.S. Supreme Court ruled the Defense of Marriage Act unconstitutional, many same sex couples remain in limbo and without benefits due to evolving administrative policies and/or to state laws that do not recognize same-sex marriages. Same-sex couples are vulnerable to financial insecurity in retirement because they are often: treated as single individuals, ineligible for widow(er) benefits from their spouses' employer-provided pension, and ineligible for the Social Security benefit boost that marriage affords to the spouses of disabled, retired, or deceased workers. Proposals to strengthen Social Security benefits for same-sex couples seek to have the federal government treat legally married same-sex couples the same as heterosexual couples, including benefits extended to dependents, regardless of their state of residence or the location where their marriage ceremony occurred. Some also call for amending the language in the Social Security Act to eliminate gender-specific pronouns (Estes, 2012).

Creating New Social Insurance Programs

Just as Congress amended the Social Security Act to add Medicare as a new program in 1965, some proposals to strengthen Social Security seek to introduce other innovate programs to the Act in an effort to boost economic and health outcomes for U.S. workers. Proposals in this category include:

- Providing paid medical and family leave for workers. Despite enactment of the Family and Medical Leave Act, which required covered employers to allow workers job-protected, unpaid time off for specific medical and family purposes, it remains a financial hardship for many workers to take unpaid

leave. One proposal establishes a national paid family and medical leave program, as part of Social Security, that would provide partial wage replacement for workers across the country who temporarily need to take time off from their jobs to tend to their own medical condition, to care for an ill family member, or to take care of and bond with a newborn or newly adopted child (Boushey, 2014).

- Extending wellness benefits to all workers and their families. Wellness insurance is a proposed social insurance program designed to protect workers and their families against the risk of chronic illnesses that are costly to individuals and society (Rockeymoore M. , 2009). Financed primarily by a dedicated worker- and employer-supported payroll tax directed to a new Social Security trust fund, wellness insurance would support eligible workers and their family members in their effort to lead healthier lives by facilitating access to subsidized primary prevention services such as gym memberships, nutrition and weight management classes, tobacco cessation interventions, and chronic disease management programs among other vital supports. Access to wellness insurance can make future retirees healthier while also enhancing their financial position by reducing their out-of-pocket medical expenses. It could also increase health cost savings by reducing the incidence of preventable chronic diseases in the United States.

CONCLUSION

While the focus of this hearing is on strengthening Social Security for future retirees, it is important to note the many proposals seeking to strengthen and expand benefits for disabled workers and dependents. In this category, common proposals include eliminating the requirement that new disability beneficiaries wait 24 months before gaining Medicare eligibility, eliminating the benefit reduction that accompanies eligibility for disabled widows benefits, allowing benefits for dependent disabled adult children to be reestablished after a divorce, and reducing the disability claims backlog and increasing fairness in the disability determination and claims processes.

Other administrative proposals for strengthening Social Security include equalizing the reporting threshold for earnings credits required for household workers and other workers, providing comprehensive language and translation services at all Social Security offices and virtual sites, and strengthening Social Security's data collection and reporting.

In conclusion, Social Security has helped provide economic security for American workers and their families for 79 years. Social Security has not only helped to keep these working families out of poverty, it also has helped them maintain a standard of living that would not otherwise be possible when they are faced with death, disability, or retirement of a family member. Given the multiple factors undermining retirement security for future retirees, it is imperative that we adopt strategies that

can strengthen and expand Social Security to meet the needs of an increasingly diverse and economically insecure 21st century workforce.

Mr. Chairman, thank you again for this opportunity to present this important information to you and your Senate colleagues.

Opening Statement of Hon. Patrick J. Toomey, a U.S. Senator from Pennsylvania

Thank you, Mr. Chairman, and thanks for calling this hearing. It is an extremely important topic.

And I completely agree with the part of your analysis about the importance of the program, which is exactly why we have to take the measures necessary to ensure that Social Security will actually be there for future generations, so that it can play the vital role for them that it has played in recent decades and past decades.

But part of that means acknowledging some of its fundamental problems. Number one, the program is insolvent. The present value of the promised benefits is much greater than the present value of the revenue that is meant to pay those benefits.

And that is not a problem with some distant future implications. It is running a cash flow deficit now. It has been since 2010—over $200 billion in deficits the last four years, and $75 billion per year (on average) going forward. This is the amount by which payroll tax revenue, which is meant to fund the program, is less than outgoing benefits.

Structural reform is necessary, and the sooner we do it, the better. Unfortunately, if we cannot agree that there is a problem, it is hard to make progress on the solution.

The observation that this is a problem, by the way, is not a partisan matter. I think it is a matter of arithmetic.

I want to quote briefly from the Social Security Trustees 2013 Report. This is the Social Security program describing itself. It says that "Both the Social Security and Medicare programs face substantial financing shortfalls that require legislative corrections. It is important to grasp that the amount of time remaining to enact a financial solution is far less than the amount of time projected before final depletion of Social Security's combined trust funds. If lawmakers take action sooner rather than later, more options and more time will be available to phase in changes so that the public has adequate time to prepare. Earlier action will also help elected officials minimize adverse impacts on vulnerable populations, including lower-income workers and people already dependent on program benefits."

As the Social Security actuaries have noted, the fundamental problem is that spending in the program is increasing faster than the economy is growing. That is pretty much the definition of unsustainable. Over the next 10 years, the forecast is for nominal GDP to grow at 4.5 percent per annum, while Social Security will grow at 6.1 percent per annum.

Tax increases are not the answer. Tax increases will not bring spending growth in line with GDP growth and will be economically destructive. Since President Obama has taken office, we have seen $1.8 trillion in tax hikes over a 10-year period, and economic growth is anemic—only one-tenth of 1 percent last quarter, and we have the lowest labor force participation rate in 35 years. These are not coincidences.

I should also point out that the math does not work very well. Even, for instance, if you completely eliminated the current existing $117,000 cap on the maximum earnings that are subject to the payroll tax, it would amount to a massive tax increase and the program would return to a deficit position in 11 years.

The solution is that we have got to change the rate of growth and bring it into line with GDP growth. No government program can grow faster than the economy indefinitely, so we have got to make the decisions. And the sooner we do it, the better it will be for the people who depend on this essential program.

So thanks again, Mr. Chairman. I look forward to the testimony of our witnesses.

COMMUNICATIONS

Submission of William H. Samuel, Legislative Director
American Federation of Labor and Congress of Industrial Organizations (AFL-CIO)

To the
Senate Finance Committee,
Subcommittee on Social Security, Pensions, and Family Policy

"Strengthening Social Security to Meet the Needs of Tomorrow's Retirees"
May 21, 2014

Two years ago, the AFL-CIO Executive Council issued a statement calling on policy makers "to stop thinking of Social Security as a problem and start thinking of it as a key solution to our retirement security crisis." We hope this hearing is a step in that direction, and thank Senator Brown for his leadership in addressing our nation's retirement income crisis. This statement is submitted on behalf of the AFL-CIO's 56 affiliate unions, its community affiliate, Working America, and their 12.5 million members.

The magnitude of our retirement income crisis has been well documented, including by this hearing's witnesses. Far too many Americans have little, if any, hope of retiring with financial security. Taking into account all sources of income and assets, the Center for Retirement Research at Boston College estimates that the gap between what working Americans will require in retirement, and what they actually have, is $6.6 trillion. Further, they estimate that more than half of working-age households are at risk of not being able to maintain their standard of living in retirement. It is no wonder that, rather than looking forward to a well-deserved rest after a lifetime of hard work, many working people view the prospect of retirement with fear.

When first enacted, Social Security's retirement benefit was intended to provide a floor of protection against the hardships of poverty. Today, however, Social Security has become the most important source of Americans' retirement income. The statistics are sobering. According to the National Academy of Social Insurance, seniors with less than $20,150 in total annual income, get more than 80% of this income from Social Security; those with income up to $32,600, get two thirds from Social Security; those with annual income up to $58,000 get almost half from Social Security.

Despite Americans' increased reliance on Social Security for economic security, the policy debate has been dominated by calls to cut benefits through a variety of means, including

increasing the full retirement age (already scheduled to increase to 67 for people born after 1959), reducing starting benefits for many lifetime middle-wage earners and higher through the use of so-called "progressive price indexing," and changing the measure for Social Security's annual cost-of-living increase.

The solution to the retirement security crisis overall also has thus far eluded policy makers. If we had the ability to start from scratch and design an effective and cost-efficient means of ensuring retirement security for working Americans, it would include a sharing of responsibility among employers, employees and the government; pooled assets; professional management; portable lifetime benefits paid out only at retirement; efficient and transparent administration; and effective oversight. Social Security meets all these benchmarks.

Social Security benefits, however, are too modest. Last year, the average benefit was just $1,270 a month -- $15,240 for the full year -- and the average wage was about $44,000. Thus, Social Security's "income replacement rate" was 35%, one of the lowest of all the industrialized countries. Social Security retirement benefits must be increased across the board. In addition, Social Security's annual cost-of-living increase should reflect the higher health care costs faced by seniors.

Contrary to conventional "wisdom," Social Security is not in crisis. According to both the Social Security Trustees and the Congressional Budget Office, Social Security can meet 100 percent of its obligations until 2033. After that, even without any changes, 75 percent of scheduled benefits can be paid. Social Security has its own dedicated funding separate and apart from the rest of government, it is legally prohibited from borrowing or going into debt and it is not a significant driver of long-term fiscal imbalances.

As a number of plans put forward in recent years have demonstrated, Social Security's modest long-term funding shortfall can be addressed with added revenue. What all of these plans have in common is that they would tax income above the existing taxable earnings cap and this must be part of any solution.

Support for Social Security transcends demographics and party identification. The vast majority of Americans believe Social Security is more important than ever and that its benefits should be increased. The American people understand that Social Security is the solution, not the problem, and it is time that policymakers in Washington followed their lead.

Written Statement of
David Stacy
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Human Rights Campaign
1640 Rhode Island Avenue, NW
Washington, DC 20036

To the
Committee on Finance
Subcommittee on Social Security, Pensions, and Family Policy
United States Senate
Hearing on Strengthening Social Security to Meet the Needs of Tomorrow's Retirees
May 21, 2014

Mr. Chairman and Members of the Committee:

My name is David Stacy, and I am the Government Affairs Director for the Human Rights Campaign, America's largest civil rights organization working to achieve lesbian, gay, bisexual and transgender (LGBT) equality. By inspiring and engaging all Americans, HRC strives to end discrimination against LGBT citizens and realize a nation that achieves fundamental fairness and equality for all. On behalf of our 1.5 million members and supporters nationwide, I am honored to submit this statement into the record for this important hearing on strengthening Social Security.

LGBT people live in 99.3% of all U.S. counties, work in every sector of the economy, and are raising at least 250,000 children.[1] An estimated 1.5 million LGBT seniors are living in America today, by 2030 this number is expected to double.[2] The unique contributions and needs of this population cannot be ignored. Same-sex couples, their children, and the growing number of LGBT older adults are at an increased risk of poverty due to systemic discrimination coupled with a lack of uniform relationship recognition. LGBT people--especially the elderly-- have lower incomes and are less likely to be able to save for retirement or disability, because of lifelong discrimination.

Income disparity is experienced even more acutely by older bisexual women, lesbians, and couples. This stark income gap is the result of years of living at the intersection of compounding inequality caused by occupational segregation, pay inequality, increased caregiving responsibilities that take women out of the workforce, and discrimination based on sexual orientation. A lifetime of lower earnings also results in lower retirement savings or pensions, and drastically lower social security benefits. Lesbian couples over the age of 65 are twice as

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[1] Marriage for Same Sex Couples, The Williams Institute, http://williamsinstitute.law.ucla.edu/headlines/marriage-for-same-sex-couples/.

[2] *Improving the Lives of LGBT Older Adults*, 2010. Services and Advocacy for Gay, Lesbian, Bisexual and Transgender Elders (SAGE) and the Movement Advancement Project. Available at: http://www.sageusa.org/specialevents/home.cfm?ID=71.

likely to be living in poverty as heterosexual married couples[3] and older African American lesbian couples have the highest incidence of poverty of all couples.[4] After living a lifetime experiencing discrimination based on sex and sexual orientation, these lesbian and bisexual women are increasingly vulnerable and dependent upon federal benefits like Social Security.

The Social Security system was designed as a safeguard against poverty and to ensure that older Americans can continue to cover basic expenses as they age. Spousal Social Security benefits provide much needed financial support for families when a spouse leaves the workforce or passes away. Despite the severe and well-documented need, same-sex couples are denied this basic safeguard and are too often forced to navigate continued economic discrimination.

Last summer's Supreme Court's decision in *U.S. v. Windsor* opened the door for many couples to gain access to federal spousal benefits for the first time. Same-sex married couples living in states that recognize their marriages are eligible for all federal spousal benefits including Social Security spousal benefits. However, despite being legally married, couples living in the remaining 31 states are denied spousal benefits by the Social Security Administration simply based on where they live. This results in the denial of all benefits regardless of the length of the relationship, the number of children in the household or legal recognition of the marriage on the state or local level. The financial loss is compounded for families whose children are also not recognized, due to exclusionary state adoption laws. Additionally, as the baby boomer generation ages over the next ten years, the number of LGBT older adults is expected to grow exponentially. The denial of Social Security benefits based exclusively on sexual orientation and state of residence will put this vulnerable population at an even greater risk of isolation and poverty.

Thank you for the opportunity to submit this testimony. As you weigh the issue of strengthening Social Security for future generations, I urge you to also consider the impact of the existing discriminatory exclusion on thousands of same-sex couples, and the significant challenges facing these couples and their families as they age and leave the workforce. We urge Congress to take tangible steps to begin to address these inequalities by ensuring that every lawful marriage is recognized by the federal government, and that LGBT families benefit equally from vital Social Security safeguards.

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[3] *Poverty in the Lesbian, Gay, and Bisexual Community*, March 2009. Randy Albelda, M.V. Lee Badgett, Alyssa Schneebaum,, Gary J. Gates; The Williams Institute. Available at: http://williamsinstitute.law.ucla.edu/wp-content/uploads/Albelda-Badgett-Schneebaum-Gates-LGB-Poverty-Report-March-2009.pdf.
[4] *Id.*

Written Statement for the Record
Committee on Finance, Subcommittee on Social Security, Pensions, and Family Policy
United States Senate

For a Hearing on: Strengthening Social Security to Meet the Needs of Tomorrow's Retirees
Held on May 21, 2014

Andrew Maner, Managing Partner, US Federal, IBM Global Business Services

Chairman Brown, Ranking Member Toomey, and Members of the Subcommittee:

Thank you for the opportunity for IBM to comment. Benefit or revenue changes are not the only options to improve Social Security. Administrative improvements at the Social Security Administration (SSA), especially in SSA's disability programs, can enhance the integrity, consistency, accuracy, fairness, and efficiency of the claims process, build public confidence in SSA, and strengthen Social Security.

1 Introduction

Over the past 75 years, IBM has worked as a trusted partner with SSA in implementing many generations of leading-edge technology. From the new IBM Type 77 Collators in the 1930s (developed by IBM specifically for the new Social Security Board), then in the 1950s SSA's first electronic computing device (the IBM 604 Electronic Calculator) and first large-scale computer (the IBM 705), followed in the 1990s by SSA's workhorse case processing system (the IBM AS400/Content Manager), and, after the turn of the 21st century, to the first uses of modern analytics and predictive modeling (the Quick Disability Determination [QDD] and Compassionate Allowances [CAL] projects), SSA has turned to IBM for innovative solutions in its most difficult challenges.

IBM encourages greater emphasis and focused funding on accelerated information technology (IT), and systems modernization through greater use of analytics. By employing "scoring engines" and other data analytics, like those developed for QDD and CAL, the quality, speed, and accuracy of Social Security Disability Insurance (SSDI) and Supplemental Security Incomes (SSI) decisions can be greatly improved. Analytics tools will also help identify improper payments, and patterns of fraud and abuse, to alert investigators and provide deterrence.

Over the last ten months, IBM has engaged with SSA technology, business staff, and thought leaders on the most effective use of predictive analytics, to detect disability improper payments, and cognitive computing, to assist disability examiners and ALJs, through IBM's Watson decision support system. Engagements have included:

- Sponsoring an industry briefing in August 2013 at SSA Woodlawn,
- After extensive discussion with SSA thought leaders, submitting a proposal to establish an SSA/industry/academic Virtual Center for Program Integrity, and
- In coordination with the SSA Deputy CIO, developing an advanced technology workshop for SSA technology and program staff, including a view of SSA operations in 2030 that includes cognitive computing and innovation.

IT-enabled Analytics

The disability determination process can be long and difficult. Complex eligibility rules and many layers of review, with multiple handoffs, make the disability programs costly to implement and difficult to manage. According to recent Congressional hearings, inconsistencies in decision outcomes erode public faith in the programs. Improving program consistency, speed, and accuracy will reserve limited funds for those applicants most in need.

Data Predictive Modeling

Creating a **predictive modeling system** to support the SSA disability decision process at the Examiner and Administrative Law Judge (ALJ) levels would:

1. Allow SSA to analyze the data from decisions made by Examiners and ALJs;
2. Provide a foundation of institutional knowledge across all offices, states, and regions;
3. Significantly improve Examiner and ALJ decision quality and consistency; and
4. Predict fraud and eligibility, and the value of streamlined process improvements.

SSA could benefit from the experience of the Center for Medicare and Medicaid Services (CMS) in standing up its Center for Program Integrity (CPI) Fraud Prevention System (FPS), which, during Fiscal Year (FY) 2012, its first year of operation, prevented, or identified for follow-up, $115.4 million in improper payments through the use of predictive modeling analysis. The FPS is an increasingly effective primary tool of CMS CPI as part of the Health Care Fraud and Abuse Control (HCFAC) program. HCFAC resulted in recovery of $4.2 billion in FY2012.

Predictive modeling can improve today's Examiner and ALJ decisions. However, the larger challenge of overhauling the examiner and ALJ systems can be accomplished through the use of a cognitive computing system, which would transform the entire SSA disability determination process by increasing accuracy, consistency, and speed, and saving billions of dollars over time.

Watson™ Decision Support in Disability Determination

Today, one of SSA's biggest challenges is its disability claims processing systems, a challenge reflected clearly in the Agency Strategic Plan, Strategic Goal #1, to Deliver Quality Disability Decisions and Services. Addressing this goal, SSA intends to reduce waiting time for decisions and reduce case backlogs, improve disability policies, procedures, and tools, and expedite cases for the most severely disabled. (See Agency Strategic Plan, Securing Value for America, Fiscal Years 2013-2016, Social Security Administration. http://www.socialsecurity.gov/asp/plan-2013-2016.pdf) IBM is ready to help SSA achieve this strategic goal by deploying the newest and most innovative tools available.

IBM® Watson™ is IBM's leading-edge technology that has been successfully adapted to address important business issues in many industries, including medicine and healthcare. Although Watson™ initially made a name for itself by defeating the top Jeopardy! Champions on television, this technology has been further refined and improved, resulting in its deployment in a wide variety of more practical uses. Watson™ has addressed the challenges of cancer diagnosis and treatment at Memorial Sloan Kettering Cancer Center, Cleveland Clinic, and at the M.D. Anderson Cancer Center, and improved utilization management at WellPoint. These, and other current uses, are described in more detail in Section 4. Given the strong similarities between the SSA disability decision process and the processes (such as medical diagnosis) that Watson™ addresses now in the real world, IBM strongly believes that Watson™ can address current issues with the SSA disability determination process to improve the consistency, accuracy, and speed of its disability determinations. IBM® Watson™ represents an initial step into a new era of cognitive computing. Examples of the revolutionary new capabilities that can be applied to the SSA disability decision process include:

- Natural Language (Processing (NLP)—which can help decision makers understand the complexities of the mass of structured and unstructured data associated with disability claims
- Panels of responses—based on evidence gleaned from relevant data within the vast troves of SSA data.

IBM® Watson™ does not make decisions. Rather, it serves as an unbiased advisor to decision makers, using the power of cognitive computing to augment the decision makers' own capabilities. IBM® Watson™ is not a replacement for any system currently operating and generating data at SSA—it is a cognitive learning intelligence that can take the current information and bring together reference material, historical and predicted trends, and enable insights that are possible only from this revolutionary new technology. It can transform the disability determination process by helping SSA to make decisions more consistent, accurate, and faster.

2 How Watson™ can be Applied to SSA Disability Determination Operations

As SSA Deputy Commissioner of Systems, Bill Zielinski, noted in his testimony before the House Ways and Means Committee on February 26, 2014, SSA has much of which to be proud for the sheer volume of operations that it supports and the valuable assistance it provides to disabled Americans. The SSA disability determination process, however, remains complicated and time-consuming due to intricate eligibility rules, the inherent subjectivity of the evaluation, and other factors. In addition, processing disability claims can involve many layers of review with multiple hand-offs from one person to another, which make the disability programs costly to administer. Other major problems with SSA's current system for determining eligibility for disability benefits include:

- The length of time it takes to process a claim to completion;
- The variability in decision outcomes among different state Disability Determination Services (DDSs), among different Office of Disability Adjudication and Review (ODAR) offices, and between DDSs and ODAR; and
- The high rate at which decisions are reversed on appeal [See *Improving the Social Security Disability Decision Process,* The National Academies Press, 2007 http://www.nap.edu/catalog.php?record_id=11859].

These problems have resulted in high case backlogs, high case processing costs, and loss of confidence in SSA disability programs. The good news is that these problems can be solved. New and emerging technologies can extend the capabilities of Examiners and ALJs and the services they support.

IBM® Watson™ is a cognitive computing system that can be used in an advisory capacity to assist and support the SSA disability decision process. Cognitive computing systems learn and interact naturally with people to extend what neither man nor machine could do on their own. They help human experts make better decisions by penetrating the complexity of unstructured information and Big Data. IBM® Watson™, by ingesting a vast array of information—claim documents, determination process library, legal reference material, medical evidences, etc. can help reduce backlogs and accurately provide a confidence level with any decision made to approve, disapprove, or request more information at any point in the process. Additionally, data modeling can provide the disability decision makers at all levels with insights into best practices, and quickly identify decisions that are outside of the best practices.

This capability can use the existing systems already serving SSA, and not require replacement or redundancy; however, IBM® Watson™ could help identify existing redundancy in systems or processes. A Watson™ cognitive computing-based decision support system can provide the foundation for more consistent, accurate, and timely disability determinations.

Provide Recommendations to Users Based on Extensive Data

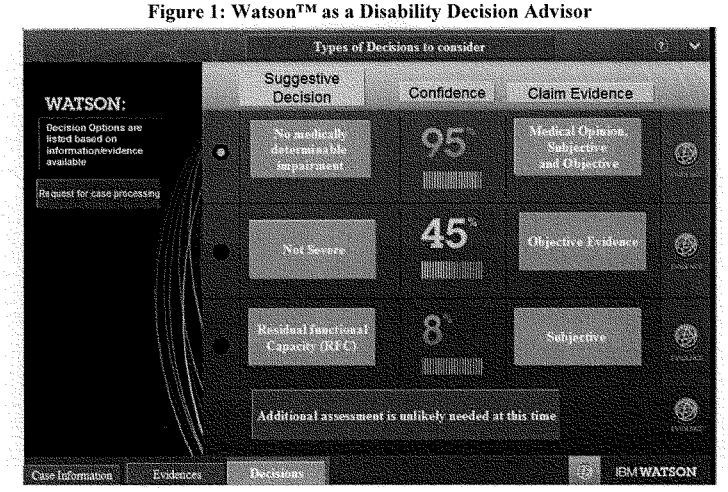
A Watson™ cognitive computing decision support systems uses Natural Language Processing (NLP) rapid analysis to interact naturally with SSA users and greatly expand the amount of information that a

decision maker can take into consideration. It can help users make better informed decisions by harnessing the vast and complex data and information that is available within SSA, as well as from external sources. The structured data in SSA and external systems, plus the extensive unstructured data within medical and other records submitted to SSA and other internal and external materials, can be assessed by SSA staff for decisions. A standard approach for considering the available information will result in decisions that are more consistent across the locations and decision makers involved.

Provide Alternatives and Confidence Ratings

A Watson™ cognitive computing decision support system understands concepts by decomposing expressions of an idea through Natural Language Processing (NLP) and then combining the results with context and the probability that certain terms in the passage convey certain meanings. Human confidence is proportional to the evidence that supports decisions. Similarly, a Watson™ system determines probabilities for disability decision points and uses reasoning algorithms to test hypotheses. It establishes a level of understanding and decomposes the decision against its probable intent. It can recompose the elements of the decision in various ways, each of which can be tested. The combinations can then be used to drive new discovery and insight, and to provide improved insight in future cases in ways that human never thought of. As illustrated in Figure 1, Watson™ advisor evaluates evidence from multiple claims against the SSA legal reference library and suggests decisions with a confidence level associated with each decision.

Figure 1: Watson™ as a Disability Decision Advisor



Embed Continuous Improvement in the Process

A Watson™ disability determination support system improves over time as it builds knowledge and learning, including disability terminology, processes, and its users' preferred methods of interacting. The system includes key disability domain expertise and adds to its knowledge base over time.

Reduce Application Processing Time and the Backlog of Applications

Watson™ can assist adjudicators to develop insights based on analysis of large sets of free text from medical records and other sources (for example applicant self-reported and claims data, disability literature, policy documents). These insights inform the disability evaluation and can be used to help the

decision maker determine pertinent case facts and findings and, ultimately, whether an application should be approved or denied. These insights can help SSA staff determine areas to focus on and what problems to focus on with an individual applicant. They provide suggestions about what alternative options to consider.

Standardize Outcomes

A Watson™ decision support system can help reduce the variability in decision outcomes among different offices, or even different decision makers by using powerful NLP, machine learning, and analytic capabilities to help make case findings and to identify problems that should be addressed and resolved in making decisions. The user can identify and view the source data relied upon by the system to make recommendations. Adjudicators can thus determine the best course of action for a given applicant.

Reduce the Rate of Reversal on Appeal

Many unfavorable initial disability determinations are overturned on appeal and approved. The initial decision could be enhanced to improve accuracy by leveraging the capability to analyze an applicant's entire record for data and other information that is relevant to the case findings and conclusions, but may not have been fully considered by an earlier decision maker. The system determines the most important areas of focus for each case. Identifying, aggregating, and displaying pertinent data allows SSA staff to focus on the key evidence and information most relevant to the case.

Other Potential Benefits

A Watson™ disability determination system can use powerful NLP, machine learning, and analytic capabilities to help with other important disability case processing goals. For example;

- Rapid access to and assimilation of complete case data leading to identification and analysis of patterns and circumstances that lead to divergent findings and conclusions and that contribute to divergent decisions at different levels of review.
- Prioritization and triage of applications to improve case processing efficiency. Quick Disability Determination and Compassionate Allowance are examples of ways to triage the incoming applications. A Watson™ solution could expand the triage approaches to include identification of high potential for denial or potential problematic cases for alternative processing.
- More reliable methods for identifying applications that may be fraudulent, applicants who may benefit from return to work programs, and/or decisions that should be subject to quality review or other follow-up.
- Methods to identify potential improper payments, for example, by uncovering individuals or organizations that submit similar or identical medical reports or who are involved with unusually large numbers of allowance cases.

3 How Does IBM® Watson™ Work?

IBM® Watson™ identifies patterns in diverse and complex information sources to gain critical insight and to enhance decision making. Watson™ is based on Deep Question-Answering (DeepQA) technology that understands natural human language. It can analyze an almost limitless range of topics and make informed judgments about those topics by understanding vast amounts of structured and unstructured data. For healthcare providers, Watson™ can provide critical and timely information to help medical staff diagnose and treat patients. The same DeepQA technology can be applied to provide critical and timely information to help SSA staff make decisions in the disability determination process.

Innovations

The link below illustrates bending the knowledge curve with IBM Watson™:

- http://www.youtube.com/watch?v=fl-K_KmUSbQ

Watson™ analyzes a "corpus" or body of data that consists of unstructured information such as text books, guidelines, how-to manuals, FAQs, benefit plans, electronic health records, and news. Watson™ ingests the entire corpus to curate content into a form that can be analyzed very rapidly. It focuses on whether the corpus content is appropriate, and sifts out information that is out of date, irrelevant, or derived from potentially unreliable sources.

Watson™ answers questions by decomposing the question, determining potential responses in the corpus, and then examining the responses in hundreds of ways. It determines a degree of confidence in its interpretation of the question and potential answers. Figure 2 illustrates the process that Watson™ uses to respond to a question.

Cognitive Computing

A Watson™ cognitive computing system mimics how humans reason and process information. Unlike traditional computers programmed to calculate rapidly and perform deterministic tasks, it can analyze information and then draw insights from that analysis by using probabilistic analytics. It learns from its own interactions with data, in effect continuously reprogramming itself.

Watson™ can transform how organizations think, act, and operate by:

- Using NLP to assess and evaluate language over unlimited topics and then making informed judgments;
- Combining natural language processing, hypothesis generation and evaluation, and dynamic learning for a powerful, fast, and accurate solution;
- Understanding complex unstructured data;
- Applying advanced analytics to weigh and evaluate responses; and
- Learning based on outcomes to get smarter with each iteration and interaction.

Natural Language Processing

Traditionally, digitized information has been structured and stored in tables or searchable and accessible cells in databases. In addition to this structured data, 80% of the world's data today is unstructured. Within healthcare, some of the most valuable information in Electronic Medical Records (EMRs) is captured in clinicians' notes. NLP allows for querying this text-based information from medical records, policy documents, and any other relevant text.

Data Corpus

It can take a long time for humans involved in disability determinations to read and synthesize case materials to make findings, conclusions, and a decision on an application. Analyzing the complete corpus empowered by Watson™ cognitive computing technology can reduce the time it takes to review a case by providing relevant and up–to-date insight gleaned from analyzing the corpus.

Iterative Internal Questions and Answers to Refine Results

Watson™ cognitive computing allows an iterative question and answer loop to provide more refined information with each iteration. This iterative process refines the system's confidence in a particular set of answers or suggestions for future queries.

Machine Learning

Watson™ machine learning allows the system to learn from the feedback from its users. It adapts quickly to the insight from users about the specific populations they serve and continuously improve the responses that provides.

Watson™ Technology to Improve SSA Disability Process

Watson™ has transformational technologies for deep unstructured question and answer analysis, content analysis, and evidence-based reasoning that elevate the power of structured data analytics. NLP and machine learning can leverage SSA's unstructured disability claims and beneficiary information, as well as information from external sources.

Innovations

SSA & IBM: 75 Years of Innovations

- 1930s IBM Type 77 Collators
- 1950s IBM 604 Electronic Calculator
- 1990s IBM AS400/Content Manager
- 2000s Quick Disability Determination (QDD) and Compassionate Allowances (CAL) projects

Benefit to SSA: IBM provides leading edge technologies help SSA meet operational goals

Queries and systematic analysis can assess unstructured data such as medical and expert notes, journal articles, and disability literature. A specific Watson™ solution for SSA can be designed to handle questions that produce a small set of prioritized answers—for example, concerning a beneficiary's disability circumstances—that can be explored to further understand the extent of disability and the evidence that supports it. SSA staff use their judgment to evaluate the responses provided by the Watson™ system. Analysis of large volumes of unstructured text to support the decision making process can potentially reduce the time required to make decisions and improve the consistency of the decisions.

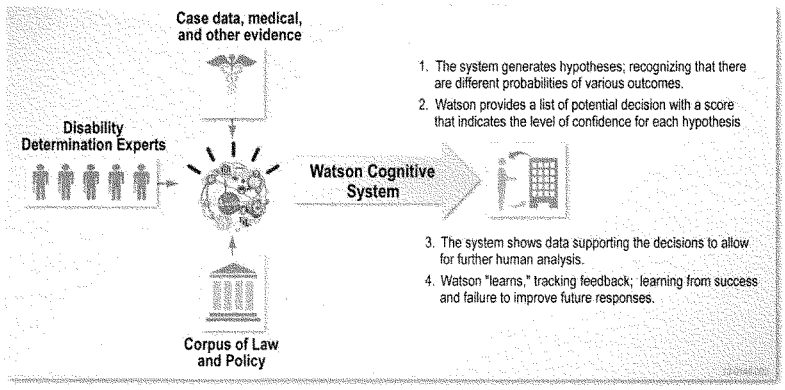
The *Watson™ overview* in Figure 3 suggests the Watson™ advisor interaction with many business users and interfaces with existing applications and services, and is envisioned to provide its own services for other applications. Sources of internal SSA and external information that could be included in a disability determination solution are listed in Table 1.

IBM Watson™ has advanced unstructured data analytics, NLP, and work-load optimization. These capabilities can be applied to answer disability determination queries based on the specific case facts along with a body of knowledge in the corpus. Watson™ can learn from past cases and guidelines and develop increasingly sophisticated expertise in disability determinations. Understanding the meaning and context of human language and rapidly processing information to find precise answers to complex questions can transform how computers support SSA programs.

Table 1: Structured and Unstructured Information for Watson™ Analysis

Disability Determination Reference Materials	Disability Determination Case Materials
Regulation Basis Code (RBC)	Disability Case Processing System (DCPS) data
Applicable Law and Regulations	DDS Case Processing Data (iron Data and MIDAS)
Social Security Rulings	eCAT data
Listing of Impairments	Applicant background data (e.g., age, employment history, marital status, financial resources)
Applicable case law	Applicant disability data (e.g., impairments, treatment, tests, limitations)
SSA operating instructions and procedures	Applicant work history, education, and training
Medical Dictionaries	Other information related to the alleged disability
Disability Dictionaries	Other disability benefits
Historical Case Data	Medical records, exams, test results
	Case notes

Figure 3:Watson™ Overview



4 Examples of Watson™ in Healthcare

Healthcare has been one of the focus industries for the initial Watson™ solutions. Since its introduction, Watson™ has become 240% faster and 75% smaller. Watson™ can now run on a single server, which is the size of four stacked pizza boxes, onsite or through the cloud. There are many use cases for using Watson™ cognitive computing to improve healthcare research and delivery. Some early implementations of Watson™ in healthcare are the WellPoint utilization management solution, the Memorial Sloan-Kettering cancer diagnosis system, and systems at the Cleveland Clinic, and the MD Anderson Cancer Clinic.

Innovations

The link below illustrates the IBM Watson™ Demo for Oncology Diagnosis and Treatment:

- http://www.youtube.com/watch?v=HZsPc0h_mtM

WellPoint Utilization Management

IBM worked with WellPoint to develop a new approach to utilization management (UM): using the cognitive system IBM® Watson™ to provide approval suggestions to nursing staff based on clinical and patient data. WellPoint trained Watson™ with 18,000 historical cases. The UM system uses hypothesis generation and evidence-based learning to generate confidence-scored recommendations that help nurses make decisions.

The project started with a pilot in which WellPoint used Watson™ for 1,500 real-life cases, with very favorable results. Less than 1 year after beginning the pilot, the system went into production at five provider offices. *"The power of Watson™ to bring information and data together, [and] make it relevant where decisions are being made, turns it into knowledge at the point where it can make a difference,"* says Lori Beer, WellPoint executive vice president.

Benefits that WellPoint has realized include:

- Nurses make faster UM decisions about treatment requests
- Accelerate healthcare preapprovals, which can be critical when treatments are time-sensitive
- Incorporate more information (unstructured data) in the streamlined decision process

Memorial Sloan-Kettering Cancer Center

Memorial Sloan-Kettering Cancer Center (MSKCC) worked with IBM® to develop a solution for cancer diagnosis. Beginning with breast and lung cancers, the solution consolidates clinical expertise, molecular and genomic data, and a vast repository of cancer case histories. *"Watson's capability to analyze huge volumes of data and reduce it down to critical decision points is absolutely essential to improve our ability to deliver effective therapies and disseminate them to the world,"* says Dr. Craig Thompson, president and CEO of MSKCC.

The solution includes supporting evidence with every suggestion, both to provide transparency and to aid in the doctor's decision-making process. Watson™ points out areas in which more information is needed and updates its suggestions as new data is added. Ultimately, Watson™ is expected to facilitate access to the best of oncology's collective wisdom. *"What Watson™ is going to enable us to do is take that wisdom and put it in a way that people who don't have that much experience in any individual disease can have a wise counselor at their side at all times and use the intelligence and wisdom of the most experienced people to help guide decisions,"* says Dr. Larry Norton, deputy physician-in-chief for breast cancer programs and medical director for MSKCC.

Benefits that Memorial Sloan-Kettering has achieved include:

- Support for evidence-based suggestions for oncologists' decisions
- Incorporates patient data and massive volumes of medical literature, including journal articles, physicians' notes, and NCCN guidelines and best practices to provide recommendations
- Continued improvement as new oncology techniques, treatments and evidence are developed

Innovations

The link below illustrates the IBM Watson™ and WellPoint:

- http://www.youtube.com/watch?v=_TNE5uMH_q4

Cleveland Clinic Lerner College of Medicine of Case Western Reserve University

After a year-long research collaboration with faculty, physicians and students at Cleveland Clinic Lerner College of Medicine of Case Western Reserve University, IBM Research has unveiled two cognitive computing technologies that can be used by Watson, and are expected to help physicians make more informed and accurate decisions faster and to cull new insights from electronic medical records (EMR). The projects known as "WatsonPaths" and "Watson™ EMR Assistant" will create technologies that can be used by Watson™ in the domain of medicine.

With the WatsonPaths project, IBM scientists have trained the system to interact with medical domain experts in a way that's more natural for them, enabling the user to more easily understand the structured and unstructured data sources the system consulted and the path it took in offering an option. The Watson™ EMR Assistant project aims to enable physicians to uncover key information from patients' medical records, to help improve the quality and efficiency of care.

"*Through our research collaboration with Cleveland Clinic, we've been able to significantly advance technologies that Watson™ can leverage to handle more and more complex problems in real time and partner with medical experts in a much more intuitive fashion. These are breakthrough technologies intended to assist future versions of Watson™ products.*" said Eric Brown, IBM Research Director of Watson™ Technologies.

University of Texas MD Anderson Cancer Clinic

The MD Anderson Cancer Clinic uses the IBM Watson™ cognitive computing system for its mission to eradicate cancer. Following a year-long collaboration, IBM and MD Anderson will showcase a prototype of MD Anderson's Oncology Expert AdvisorTM powered by IBM Watson. Watson's cognitive computing power is being leveraged to help patients by

Innovations

The link below illustrates IBM's Breakthrough: Watson™ May Help Beat Cancer:

- http://www.youtube.com/watch?v=HkEOJnn_zlg

enabling clinicians to uncover valuable insights from the cancer center's rich patient and research databases.

MD Anderson's Oncology Expert Advisor powered by IBM® Watson™ is designed to integrate the knowledge of MD Anderson's clinicians and researchers, and to advance the cancer center's goal of treating patients with the most effective, safe, and evidence-based standard of care available. Starting with the fight against Leukemia, MD Anderson's Oncology Expert Advisor is expected to help MD Anderson clinicians develop, observe, and fine-tune treatment plans for patients, while helping them recognize adverse events that may occur throughout the care continuum. The cognitive-powered technology is expected to help researchers advance novel discoveries.

MD Anderson's Oncology Expert Advisor is accessible to the cancer center's network of clinicians through a computer interface or supported mobile devices. This provides clinicians—and in turn, patients—with immediate, worldwide access to MD Anderson's expertise and resources, and to IBM Watson's technology prowess in quickly extracting crucial insights from large volumes of complex data.

5. Summary

IBM is leading the Cognitive Systems Era. We are transforming how organizations use information and make decisions.

Watson™ technology can be applied to the SSA disability determination process to provide a "trusted advisor" to those who make disability decisions. Watson™ provides not only recommendations but information that supports those recommendations. Each recommendation is scored based on relevance. The individual using Watson™ evaluates the information presented and ultimately decides whether to use some, all, or even none of that intelligence. Watson™ makes data fully transparent so users can examine the sources of recommendations if the wish. While users are not obligated to use and act on the intelligence generated by Watson, they can incorporate the results into the decision-making process, balancing and/or augmenting their own existing knowledge and expertise.

A full production Watson™ can benefit SSA and its decision makers in myriad ways. Watson™ can improve decisions by enabling increasing levels of insight at each step of the disability decision-making and review processes and SSA can use Watson™ to provide more consistent, accurate, and timely disability determinations. Watson™ is designed to augment human intelligence; not replace it. These capabilities can support the Social Security Administration disability determination process by:

1. Reducing case processing time and costs by helping decision makers take control of the vast quantities of information and data that needs to be reviewed and analyzed
2. Reducing the variability in decision outcomes among different state Disability Determination Services (DDSs), among different ODAR offices, and between DDSs and ODAR by providing a rigorous, consistent framework for case adjudication
3. Reducing the high rate at which decisions are appealed and reversed on appeal by improving the decision quality at the initial determination step and providing a higher confidence level in case outcomes

As a result, SSA can expect significant cost savings, reduced case backlogs, greater decision consistency, more transparency, and greater accountability throughout the agency.

After working together for almost 8 decades, and reviewing the new SSA Strategic Plan released in March 2014, IBM recommends cognitive computing technology as a critical enabler to transform the Disability Determination program.

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