RETIREMENT SECURITY

Agenda for Shared Prosperity transcript — Nov. 20, 2007

ROSS EISENBREY

RE: Good morning, everybody. Whoa, that's nice and loud. Please turn off your cell phones and we'll begin. I'm Ross Eisenbrey, the Vice President of the Economic Policy Institute, and I'm honored to welcome all of you here today to EPI to introduce today's program and the very distinguished panel of experts who we've gathered to speak today. I'll introduce each of them before they speak, beginning with Professor Ghilarducci, but let me start by putting today's program into context. And even before that, let me single out one foundation and one individual for their enormous contributions to today's event.

The Rockefeller Foundation provided very generous support to our research effort and to this event and we're very grateful for that. I also want to thank in particular Monique Morrissey, an economist on our staff, without whose steady, intellectual support and expertise this whole project would have fallen apart a long time ago. So, thanks to them both. EPI's Agenda for Shared Prosperity is about protecting and restoring the American dream, which a majority of Americans now believe will allude the next generation, if not their own.

The rising inequality and increasing economic pressure on the middle class from globalization, the decline in unionization and bad public policies are threatening the financial security of average Americans in ways we haven't seen in more than 60 years. Today's program is the ninth in a series that is examining every aspect of the American economy to understand its strengths and weaknesses and to develop policies that will deliver a better result for the greatest number of our fellow citizens.

Our guiding principle is that these policies have to be at the scale of the problems they address. Today we address retirement security and, as you will learn, the problems are enormous. Retirement security has been a key part of the American dream and bad public policy now is playing a huge role in undermining it. Thanks largely to social security, most Americans since the Second World War could expect to retire, to stop working before they die and to enjoy several years of leisure at the end of their life.

Increasingly, they could expect enough income from social security, pensions or savings to maintain the standard of living they had while they worked or something close to it. In fact, the average age of retirement fell dramatically from 1950 to 1970 from about 68 years to about 62 and a half before leveling off. With growing unionization came shared prosperity and increasing pension coverage. Americans lived longer but were able to retire earlier.

But those golden years are, if not gone, they're disappearing. The conservative "you're on your own", what we call "yo-yo economics" of the past decades, have accelerated the decline of traditional pension plans, the disappearance of employer-provided healthcare and, ironically, personal savings. Today fewer than 20% of private sector workers are covered by a traditional pension and the national savings rate is near zero. With fewer financial resources and fearful of losing health insurance, more and more of the elderly are remaining in the workforce.

A quarter of those 65 and older worked in 1950 and by 1985 their employment rate had fallen to about 10%. Today it's 15% and rising. As you will hear today, if we don't change federal policy, the dream of a decent retirement will be denied to more and more of our citizens, even as the productivity and wealth of the nation continues to increase. So what's wrong with current policy?

First, congress weakened the foundation of retirement security by cutting social security benefits when just the opposite is called for.

And a two-decades-long campaign by conservative think tanks and politicians has been allowed to use a relatively small potential funding gap to weaken public confidence in social security. As you'll hear today, far from being in crisis social security is the strongest part of the U.S. retirement system and will be stronger and more effective than the voluntary employer-based pension system or private savings far into the future. Simple and fair changes in tax law can erase any worry about the program's funding without cutting the already modest benefit levels.

Yet, thanks to the gullibility or complicity of the media, most Americans under 50 think social security won't be there for them when they need it. The second big policy problem has been that congress has encouraged employers to replace traditional pension plans with individual account plans, shifting both the risk of investment loss and the cost of saving for retirement from the employer to the individual worker, the party least able to manage them. A real pension guarantees a steady stream of income to retired workers.

A 401(k) plan or IRA guarantees nothing. 401(k) plans are cheaper for employers. They generate tremendous fees and profits for Wall Street and financial firms, and they particularly benefit the well-off who make campaign contributions. But 401(k)s do precious little for the average worker. After 20 years of experience we can say with confidence that 401(k) plans have not built broadly-shared retirement security; instead, they have eroded it. The nation is richer than it was 20 years ago, yet Americans nearing retirement are less prepared than they were a generation ago, and the future looks dimmer.

Tweaking 401(k)s by making enrollment automatic, by changing their tax treatment can improve them a little, but they'll never be a substitute for a defined benefit pension plan or for a strengthened social security system, both of which provide a guaranteed benefit at low administrative costs. I believe, as does our first speaker, Professor Ghilarducci, that a real solution to the problem of secure and adequate retirement income can only come from a universal program, not one that depends both on the generosity of employers and the discipline, good fortune and foresight of workers.

So the program today, as you've noticed, will be Professor Ghilarducci followed by comments from our very distinguished guest, the Controller General of the United States. We'll have questions and answers after that and then we'll move to the next panel which will focus on social security with Nancy Altman and Virginia Reno. But let me introduce now Professor Teresa Ghilarducci who is a Notre Dame Professor of Economics and has been for a quarter of a century.

In January of 2008 she's leaving Indiana and moving to New York to become the Schwartz Chair in Economic Policy Analysis at the New School for Social Research. And very important to us at EPI we have asked her to, and we hope that our board will accept her as a new member of EPI's Board of Directors in 2008. Professor Ghilarducci. [APPLAUSE]

PROFESSOR TERESA GHILARDUCCI

TG: Hi. This reminds me of a time I spent in Rome. It was the late 1990s and that event, not this event, was an interminable pension conference. We were talking about aging societies, international reform options, and for two days the only English word I heard was 401(k). It turned into a word. I had a very difficult time convincing them that the United States had a federal social insurance program called social security. It was unbelievable that we had something called Medicare.

And I really think to this day that half of the audience was convinced by my description, you know, of American policy for retirement income security. The fact is that security retirement income has been a matter for aggressive, two-part American government policy. One part is the direct administration of our mandated, universal, defined benefit system, portable between employers, called the social security system. That's the direct part. The other part is one that does distinguish us from other OECD nations in that it's indirect and it's through our tax code.

We give generous tax breaks for employer and individual-based retirement plans, defined benefit plans, 401(k) plans, individual retirement accounts and similar savings vehicles dedicated in various ways. They're dedicated, steered towards, disbursement at old age. But we'll talk about all the leakages that there are from these programs. And this part, this second part, this indirect part of our American retirement income security policy predates the Social Security Act.

We see that policy being formed from the Revenue Act of 1913. Now the tax breaks, and I'm going to say it now the third time, for employment-based retirement plans is a central part of our retirement income security policy, and they're very substantial. The taxes not collected on contributions to these plans or the earnings on these funds equal one-fourth of our contributions to social security. They are also, and this happened in the beginning of the '90s, larger than household savings.

Okay, this is a substantial part of our retirement income security policy. And this part of our policy had every good intention. We were going to help people save at work where that's the most reasonable place to save. It's convenient, people have money, it's automatic and the savings are tied to their earnings so that the income you get when you retire is somewhat tied to the standard of living you earned when you were working. And this policy of incentives through the tax code were meant to pile a virtue upon a virtue.

We intended to increase national savings and we intended to deliver retirement income security. But two decades of this ever-expanding pile of tax breaks has not yielded either one of our goals. Our savings rates are falling and we certainly have no more retirement income security. Now let me take a moment to spell out how these subsidies, these tax breaks work and when they take the form of tax deductions and they don't take the form of tax credits.

A professional earning about $200,000.00 a year gets a tax break of $340.00 when she makes her $1,000.00 401(k) contribution, but her secretary earning $20,000.00 a year gets only $150.00 tax break when she makes her $1,000.00 contribution to her 401(k). Now abstracting from the reality that she, the receptionist, is much less likely to make that contribution, you can already see, just doing the math, because of the structure of this subsidy happening through a deduction that the higher paid person gets many times more money from the federal government than does this lower income person.

What's worse is that there's a consensus in the economics literature that that upper income person, that professional, would have saved that $1,000.00 anyway. That at the top there is a one to one offset between money that is going into a pension savings. It would have gone to non-taxed, non-favored pension coverage. So we're not getting any hit with these tax deductions for our national savings. But after World War II and up until the 1980s this dual approach actually worked fairly well.

We were seeing that full-time workers, and at that point they were mostly men, were actually supplementing their social security benefits with employment-based retirement. And the coverage rates at any one point in time was about 70%. Over their careers the likelihood that they would have a supplement was over 80%. And women were catching up. I mean, there was a logic to that two-part system. But by the late 1970s or the early '80s, as congress rejected President Carter's pension commission recommendation of a mandatory universal pension system and accepted a new device developing in the private sector which was built upon a little known section of the tax code called 401(k), we had the marketing of these new income-deferral plans called (after their—the tax code section) 401(k) plans.

The history of these *[sic]* 401(k) section is actually quite interesting. A large corporation asked the IRS if they could please defer their executives' compensation directly into a retirement account. And the regulators said, "Well, okay, if you give it to everybody else". And they presumed that that would never happen, that they wouldn't extend it down. But it did happen and, to use a shop-worn phrase, the rest is history. You all know the graph. The graph goes something like this.

On this axis is plan participants' pension plans, whatever you want, and on this axis is time. You know what I mean? The DCs (Defined Contribution) are going up and the DBs (Defined Benefit) are going down. Right? That's the history we all know. But there's five other parts of this history that isn't well advertised. One is that these new DC plans, these new 401(k) plans, never expanded to people who otherwise would not have pension benefits. Every place where 401(k)s have appeared are in industry, firm size or demographic groups that would have gotten the pensions anyway.

Over the past 20 years when you see people newly covered by pension plans, low income workers, people in industries like poultry workers or janitors who all of a sudden have a pension where they didn't—their counterparts did not have before, it's a DB plan that they've gotten usually through unionization. Now they might have a supplement, but the DB plan is that new coverage. That's one part of the history we don't know about that ascendancy.

DC plans going up, pension coverage actually flattening out and falling. The second part of the history we don't know, that congress, over the past 20 years, treated these 401(k) plans as a favored child, consistently increasing the earnings limits, meting out little discipline on fees or lump sums or other large-scale leakages, while they piled on regulation after regulation on the DB plan as if it were the over-scrutinized older brother. Right? There was this real concerted asymmetry in the way that federal policy treated these two kids of plans.

The third part of the history we don't know much about is that the replacement rates, the share of pre-retirement income represented by retirement income for future retirees, the research is showing now will be lower than it was for boomers and beyond than the rates have been for previous generations. And the rates predicted for most of us in the room are well below the modest target of 70% of our pre-retirement earnings we should have in retirement. And that target is modest because there was lots of other calculations to show that most of us should have more than 70% of our replacement rate.

The fourth part of that history we don't know well is the tax expenditures for 401(k) plans. Remember, coverages are increasing, retirement income security is increasing, but the tax subsidies for 401(k) plans are ever increasing, they'll rise 40 percent from 2004 to 2010, while that older brother, that over scrutinized older brother, the tax advantages for DB plans will fall by four percent.

And the fifth part of the history is that all the while, national savings has fallen. So we're up against this paradox.

The taxpayer subsidies, our tax dollars, are ever-climbing and the amount of retirement savings is ever-falling. What's the explanation of this paradox? It's easy, it's failure, it's failure. The tax deduction, incentive growth, the pretty please approach to retirement supplements doesn't work. Pursuing this system with even more clever incentives like opt-ins and voluntary opt-outs, better marketing, participant directed class, class activities by employer, and every other clever incentive reformers can think of won't ever work because it will face the same limitations that we're facing now, which is that 401(k)s were never intended to be a pension system. They were intended to shelter, executive pay. Twenty-one percent of those eligible for a 401(k) right now at work, don't participate, even the top income people don't always participate, that's one leakage. Forty-five percent of people who change jobs with a 401(k) cash them out, that's another leakage. Fees erode up to 20 to 30 percent of the accumulation.

We have to pay retail fees for our financial management, that's another leakage. This all means that the system of 401(k)s is more like a national severance system, income severance system people use to supplement their unemployment insurance. We need a rescue plan for American retirement hopes. Now this is a subject for another panel, but my point here is that retirement hopes are very important. We need a workforce that has a choice to retire when they want to. It turns out that retirement improves health, it improves well-being and it's a hallmark of every civilized society.

So this paper, this panel, is predicated on the assumption that retirement is a good thing, retirement choice is a good thing. We need a rescue plan for that second tier, the employer-based pension system and I'm proposing one. I propose that Congress create guaranteed retirement accounts, it has six easy to remember, you can tell I'm a teacher that stepped out of the classroom, points. It has one, each worker and their employer, will contribute 2.5 percent of pay, up to the social security maximum, to an individual guaranteed retirement account.

Every employee will get a $600 tax credit, which pays for the contributions of most workers. You can just do the math, 2.5 percent of the median wage is about $600, it's even more for lower income people. This is a refundable tax credit, replacing the deduction with a credit. Three, people in qualified defined benefit plans and some money purchase plans, will be able to opt out. Four, unlike individual accounts that we have now where every worker has to find basically a retail provider, direct the investments and pay retail fees, these funds will be managed by a government entity.

The collection, the contributions will be collected by the Social Security Administration, the apparatus is already there. It will be invested by professionals, directed by a public board. The money will be in individual accounts but invested in pooled funds in a diversified portfolio. Fifth, unlike 401(k) plans where very reasonable and smart people buy high and sell low, they do it everyday, you face the fact that you might retire when there's a 10 year slump in the financial market. The federal government being the only entity that can do this.

The federal government will guarantee a real return on your contribution of three percent. Through the generous grant of the Rockefeller Foundation, we looked at what this plan would have done over the past 40 years and the fund more likely would have earned more then a three percent real return, invested professionally with no retail fees. Therefore this board will have the choice of allocating this excess return, on a periodic basis, to individuals or to put into a reserve fund.

And sixth, the contribution will be converted to an annuity at retirement, no leakage in the lump sums and this means that most Americans will finally have a place where they can invest their hard earned money for retirement within a secure account with professionals managing their fees, only some of us have that now. This rescue plan will accomplish these goals. One, it will mean that everyone takes on responsibility for their own retirement, employers help, low income workers contribute, everybody saves.

At five percent contribution rate over a 40 year career, added to social security, added to social security, you get the 70 percent replacement rate. Second this plan is revenue neutral. It will be paid for by limiting the tax deductions for 401(k)s and IRAs for contributions over $5,000 per year. There is so much money being spent to encourage people to save who already would have saved that there's enough money to expand retirement savings to 50% of the workforce that doesn't have it. It's really, truly a—it's a graceful, elegant fix because it's revenue neutral. However the top one half percent of the income distribution will lose a tax break.

That could be a political issue even though that's a very small amount, and it is a re-distributive policy that will increase retirement income security and increase national savings. It's a bold plan, it's a brave plan. It has to be made. It has to be made to make sense of our two track policy for retirement income security and you heard it here first. (Applause)

MS: Thank you very much Teresa. We'll have a chance for everyone to have questions and answers. But first we are delighted and very lucky to have with us the Comptroller General of the United States, David Walker. He is the 7th Comptroller General. He was appointed in 1998, and he obviously knows something about finances and financial management by virtue of this position, but what you may not know is that he has a long history of involvement in pension and retirement policy. He was an assistant secretary at the Department of Labor for Pension and Welfare Benefit Administration.

He was the acting Executive Director of PBGC (Pension Benefit Guarantee Corporation). He was for five years a public trustee of Social Security and Medicare. He's a CPA and published author. I want to thank him in particular -- unrelated to this -- for the work that GAO has done on the Iraq war which we should all be very grateful for. But thank you very much Comptroller General David Walker. (Applause)

DAVID WALKER

DW: Thank you. I apologize for my voice but I'm just getting over a very bad cold. Professor Ghilarducci it's a pleasure to be here. I'm glad we're able to work this out and in the interest of full and fair disclosure she's on one of my advisory boards and a very active member of that so I was very pleased to do this. I would describe her paper as very comprehensive and very thought provoking. If I can, let me provide a framework for my remarks before we go to your questions I presume.

First, to me we need to focus on the concept of economic security in retirement. When you talk about economic security in retirement in my view there are a number of major contributing elements--Social Security, private pensions, personal savings, for more and more Americans earnings—through earnings through continued employment even if it's part time. But I think you can't ignore healthcare. You can't ignore Medicare. You can't ignore employer sponsored either active or retiree healthcare.

Now as far as contributors we have government, employers, individuals and others, and in some cases families or communities or community organizations or whatever. From a pension standpoint or from a retirement income security standpoint to me there are several hierarchies in the pension policy area. There's coverage. If you're not covered nothing else matters, and the simple fact of the matter is is that coverage has been stagnant for decades. I think it's been stagnant for a number of reasons. One of the reasons it's been stagnant is because of out of control healthcare cost because employers have to manage total compensation. With healthcare costs growing very rapidly that means there's less money left over for pensions -- whether it be DB or DC -- and there's less money left over for real wage growth as well.

So healthcare costs I think are clearly an adverse contributing factor to pension coverage as well as increasing global competition. After coverage you have participation, and it has been mentioned that's very skewed especially in the case of a defined contribution plan because if people have an opportunity it doesn't necessarily mean they're gonna avail themselves of the opportunity to be able to participate and clearly there has been a skewing there in the past where those that tend to be better off are more likely to participate than those that aren't, and in this regard I would agree with Teresa that our tax incented savings efforts have not proven to be successful in my view.

Number one, we have a very low personal savings rate, about the lowest of any industrialized nation on earth. Then you have to look at the equity of that savings. Not just how much are we saving but who is saving. And when you look at who is saving you clearly see that those that are better off are the ones that are benefiting. Candidly I remember in the early days when IRAs came in then I ended up taking money out of my bank account and moving it over to an IRA in order to be able to get the tax benefit, in order to be able to get the deduction. So we all probably have experienced some of these ourselves. But I don't think that the tax incentive approach has worked. I think there are very real limits as to what we can expect from employers in the current environment.

The next area would be equity. As I said that means non-discrimination and horizontal equity and there are several issues there that the professor has mentioned. Funding, how adequately is the benefit funded. Now this is a hybrid plan she's talking about so it's really funded with two and a half percent to the employer and two and a half percent from the individual. So other than the government guarantee implication hopefully it's adequately funded at all times. Fees, and as we all know -- including some GAO reports that we've issued recently -- a lot of people don't have any idea they even pay fees. They think there's a free lunch I guess, I don't know. But that can be a real issue with regard to the diminution of the most powerful force on earth according to Albert Einstein.

Remember Albert Einstein said the most powerful force on earth was not nuclear energy. The most powerful force on earth was the miracle of compounding. If you're an investor the miracle of compounding works for you, and if you're a debtor the miracle of compounding works against you. So we have the fee issue. We have the portability issue which clearly is covered here. We have preservation. It's a huge problem in the private pension system: tremendous leakage from the private pension system. Even if somebody preserves their savings through a 401(k) or other type of defined contribution plan until retirement they may not take an annuity form. They're not required to. They may not, and therefore they may end up outliving their retirement savings.

Then the last issue would be protection. As we all know defined benefit plans are guaranteed to an extent by the federal government, by the PBGC. In fact I just had breakfast this morning with the new executive director of the PBGC. But this would provide for a government guarantee of a minimum rate of return. Obviously there's a contingent liability that would have to be recognized because if something happened for a period of time there would be a contingent liability that would have to be recognized there. But as the professor has noted over an extended period of time there can just as easily be excess reserves created which could end up being dealt with through a dividend or through some type of reserve policy or whatever.

Now as far as the professor's proposal I would describe it as follows. It's very comprehensive. It involves mandatory universal coverage, but it does give an option that if you're covered by an employer-sponsored defined benefit plan which adds a certain minimum benefit, then you don't have to participate in this. But on the other hand, if you're not, then you do. So everybody presumably would be covered. It's a hybrid plan. It takes some of the features of defined contribution plans that people like and some of the features of defined benefit plans which quite frankly we need—preservation, annuity form, etc. and combines them together.

It provides for pooled investment through the Federal Savings Plan which is, by the way, one of the options that was being talked about by President Clinton as a possible option for Social Security reform. It could be done either with or without individual accounts. This one presumably would be pooled investment but you would have an individual, at least notational, account. It would change the tax treatment to provide more equity by having a refundable tax credit which deals with some of the equity issue, provides for a government guaranteed rate of return. As I said, it could create a contingent liability. It's portable, provides for preservation and some government guarantee. So it's got a lot of positive features in my view.

Now, let's don't underestimate the degree of difficulty in making something like this happen. Congress does not have a great appetite for traditional pension reform much less revolutionary pension reform, and I say that as a member of the Sons of the American Revolution I might add. I believe we need reform. We don't need revolution but we need meaningful reform in this area because I do think our system is broken at the present point in time. Several questions I would throw out in closing that I didn't see in the paper but I may have missed it so I apologize. I've been burning the candle at both ends of the stick lately so I tried to catch everything.

One of the things I think that Teresa even mentioned herself is that one of the options would be to have an add-on to Social Security that might be able to accomplish similar things. In other words, if you had a supplemental individual account that was added on to a reformed, sustainable and secure defined benefit Social Security system with a lot of these features might that be a possible option? Question. Secondly, what about conversion of existing 401(k)s? What about the possibility of somebody being able to take either when they leave their employer or otherwise have the option to convert it into this vehicle if they so desire?

Believe it or not I can't read my writing on the next note. Those of you that know my writing will very much understand why I'm saying that. But these would be just a couple of thoughts that I had, and I'm sure there are many others that those in the audience have as well. But I enjoyed reading it. I think it's very comprehensive. I think it's clearly a much more dramatic reform than we've seen in the past, and I think we need a lot more dramatic reforms in a lot of areas quite frankly because our country faces a number of major sustainability challenges that in my view were not taken seriously enough, and we need to start acting on them sooner rather than later. Thank you. (Applause)

Q & A SESSION
TG = Teresa Ghilarducci; DW = David Walker

MS: General, if you'd come back up and Teresa we'll open the floor for questions now. We'll have people in the aisles with microphones, and they can get your question.

FS: Well, are you the only one?

MS: I hate to sound so pessimistic on the first question. But mine is I worry about how regressive this is on the middle class. It seems like the refundable tax credit stops at $12,000 a year. The other thing is you're talking about FICA taxes now going up to what 12.65%. At that point I worry that a lot of folks will start paying people under the table or there'll be a huge shift of people being paid 1099. How do you address that sort of thing?

TG: The issue of 1099 has a lot more advantages than just avoiding an extra 2.5%. There are other issues. This proposal is much more progressive than anything we have right now. So my baseline is the current system that 70% of the tax breaks for retirement savings goes to the top 20%. So the middleclass gets hardly anything at all. If the middleclass got a $600 contribution towards their retirement savings that's far more than they're getting now from the government. What you might be concerned with is that this mandates that everyone start contributing to the retirement income security.

It turns out that if you survey Americans, and you survey them with [whose] twenty other nations' inhabitants [who] were surveyed, what do you want to do about this cost of aging societies? They were given these options. One was to reduce pensions. The other one was to raise the retirement age. The other one was to increase taxes. And the other one -- and this is what's distinguished between this idea that this is just a tax increase -- is to mandate savings.

The most popular option out of those four was we want someone to tell us to save more for our retirement. So this is not a tax increase. It's a mandated savings account for retirement, and that is what looks like the middleclass would benefit from given the current system. It's much more progressive.

MS: Thank you. My question is for Mr. Walker. If I understood correctly in the gentlemen's opening remarks he suggested that the Social Security funding gap is small. Mr. Walker, I was wondering if you agree?

DW: In current dollar terms discounted present value dollars 6.4 trillion dollars. That's how much money we'd have to have today invested at Treasury rates to close the funding gap on Social Security for the next seventy-five years. But that would only be good for seventy-five years, and when we do Social Security reform we need to go about it recognizing that cliff effect and trying to make sure that we make a reform that we're not pre-programmed to have to come back. Everything in the world's relative. 6.4 trillion as compared to what? Medicare is 32 trillion. The Medicare Prescription Drug bill alone is eight trillion. It's a lot of money.

When the financials come out this year by December 15th I think it'll show that our total liabilities and unfunded commitments for the United States will be about 53 trillion dollars in current dollar terms. That's up from twenty trillion in 2000.

FS: Hi. Rick McGahey with the Ford Foundation. A quick factual question for Teresa and then I guess for both of you. You said that the plan as laid out would have a negative impact on the top one-half percent of the income distribution. I just wondered what that was in dollar terms? What income was…?

TG: Average is $5,000 loss, and it will…

MS: Yeah, but I mean who is that in the income bracket?

TG: Oh, it's over—yeah, it's over $200,000. It's in the paper. It's $200,000. Right, it's $200,000.

MS: Okay. Then a question about the add-on account.

TG: It's half a million, right. It's half a million.

MS: So okay. It'll only impact people over half a million negatively. Okay.

TG: And there's not very many of them. So….

MS: Then the question about the add-on account I thought was interesting because it did seem to have a lot of features, and the way you're thinking about using the payroll tax system for it. It's a pooled account that's managed to hold the fee structure down. Is that one option? Is that a way that that could be administered or does that present difficulty?

TG: This is what I actually view it as an-add on account. That's what I meant. I didn't make that quite clear. Maybe it wasn't that clear in the paper. But it is an add-on account. That's why I can make the claim that it's not a tax increase. That it is a mandated contribution to your own savings account, to your own retirement security.

DW: In that regard I've come to the belief that we need mandatory savings. When you look at where we stand with regard to Social Security, when you look at where we stand with regard to private pension system, when you look at where we stand with regard to personal savings rates, I think the answer has to be some type of mandatory savings arrangement through payroll deduction where it's automatic. You don't have to make a judgment on it. You never touch the money if you will. Going into pool investment options with real investments, with real fiduciary responsibilities and liability, where people go to jail if they play with the money.

I mean, one of the real concerns I have about Social Security now is we spend all the Social Security surplus, and so the operating deficit for the federal government is over double what's advertised. I mean this past year I think it was advertised that the federal government's deficit was 163 billion on a cash basis roughly. Well you can add another hundred and seventy to a hundred eighty on top of that because of the Social Security surplus that's spent on other operating expenses. Quite frankly if you did the same thing in the private sector that the government does for Social Security you'd be wearing wide striped suits, okay. I mean you can't do that.

FS: If these are sold politically as individual accounts even as notional ones to avoid the problem of it's just a tax don't you worry about a political dynamic that there will be pressure very soon to open it up for good cause. I mean certainly that's happened with IRAs, with 401(k)s. Every year there is some new justification for allowing people to access their money early. Even if they were enacted initially in this regard how would you deal with that continuing pressure?

TG: Yeah, I'll start but I really want your comments too, Mr. Walker. There was that pressure with Social Security. People saw that as wealth as it certainly is our most important source of wealth for retirement income. Laws were passed that you couldn't garnish it, that you couldn't borrow against it. It was very well accepted that that was only meant for retirement. If you want money to supplement your unemployment insurance, for your kid's education, for your car or for Christmas then you just have to save it in other ways, and as I have said and it won't be on our dime as taxpayers. The taxpayers Congress did not make a decision to help fund peoples' contingent needs and give them a tax break for that. We made a decision by Congress to do it for retirement.

DW: To me there's a fundamental difference between mandatory savings and voluntary savings. When it's mandatory I think you can take a much tougher line with regard to locking up the money, preserving it, requiring it to be paid in annuity form. When it's voluntary savings I think it's a different issue. Then you get into the issue of to what extent are you gonna provide a dis-incentive for people to save because they may not be able to gain access to it in circumstances where they feel they should when they want to gain access to it. Here we're talking about mandatory.

The other thing I would say is I would agree that to the extent that you have mandatory universal savings whether it's through the guaranteed retirement accounts or whether there's an add-on to Social Security or whichever might happen.

But that's not a tax increase. It is a reduction in disposable income. There's no question about that. It's a reduction in disposable income today to hopefully be able to have a better life tomorrow. At the same point in time it's not a tax increase because it's your money, and that's why I think you would have to be very, very careful how it's structured such that either it was an individual account or at least a notional individual account so people would understand that it's their money and that you really have tough fiduciary responsibility and liability. One other thing I thought of now that I can read my writing.

One of the issues you always have when you're talking about pooled investments is what about proxy voting because you're talking about a huge pool of funds. So what happens with regard to making sure that you don't have the government trying to dictate policy through the exercise of proxies associated with these huge pools of funds?

FS: How do you protect the income, the retirement income security of people who don't work for forty years given that women still continually earn less than men and spend a decade or more out of the paid workforce than men do and that women's poverty rates are still disproportionately high. I can see how your system gets to 70% with a forty year work history, but that doesn't cover a significant part of the demographic.

TG: One of the options is that there would be some recognition for caring labor and that the tax credit would be available for that. But more importantly that is a problem that exists now. This program doesn't solve all problems. We're not going to pile on income security for all groups. It's absolutely clear. However right now Americans don't have an option to save in a low fee, professionally managed guaranteed account. What this would do is allow people who aren't in the workforce or when they move in and out of the workforce to have a place to save their money. So there is some recognition of caring labor, but the problem of mis-allocation of resources within the family is not something that this is designed to remedy as the Social Security program does.

DW: On that, I think one of the things we need to think about doing as part of Social Security reform is to take a look at strengthening the minimum benefit for people that are at the poverty level and modifying and somewhat reducing replacement rates for people at middle and upper income levels. But I think we need to strengthen the benefit there and then take a look at that.

MS: Hi. A couple questions. You talked about a 3% real return, and a lot of periods in our history we actually had a 3%--in fact we've gone sometimes ten years or more without a 3% return. The second thing which occurred to me was basically the government would be a thousand pound gorilla in the stock market with this kind of money. How would you avoid that particular problem?

TG: I'm glad you mentioned the last one so I could answer Mr. Walker. The first question I didn't expect because most people say look, a 3% real return is exceedingly low. But we're learning and we're learning our history. That's my point. No entity, an employer nor can a person, weather a ten year period like we had in the 70s where returns in the stock market were less than inflation. Only the government can take on that risk. So that would be the period of time in which there would have been a reserve to go back on because there will be periods of time when the returns will be higher than the real return.

Many nations are dealing with their retirement security problem in this way. Sweden is one, Germany, now it looks like Italy, have this system. I didn't talk about it in my presentations, in the paper, of these notional accounts where the government protects itself by only guaranteeing what it can but providing what only a government can which is the long-term view for folks.

This multi-trillion dollar gorilla in the stock market that will be represented by the government. First of all it's the amount of money we would have in our financial system if American's saved, if they saved like they did in the 1980s. So the impact of money flowing into the financial markets is a happy impact. It's what we wanted to expand the supply of loanable funds. However, attached to the ownership of equities is the right to vote and the responsibility to vote those proxies. Every shareholder should, every pension fund must. The federal government will have to decide what to do as the Federal Reserve pension plan has to decide what to do, as the TSP (Thrift Savings Plan) Board of Governors decide to do, as the PBGC. I was on the advisory board. You're (to David Walker) the executive director.

That's federal financial assets. We had to decide what to do with the proxy voting. There are clear cut policies that make that proxy voting as neutral, politically neutral as possible. I do not envision this fund, being run by the professionals and the public board, that it will make what's called socially attuned investments or policies. They will run it mostly like an index fund. I would imagine they would decide with very, very clear cut policies that political decisions would not be made in proxies. That the proxy voting would be done only to maximize the risk adjusted returns of the beneficiaries.

FS: I just want to inject a note of caution about this idea that this is a hot diggidy dog idea for add-on accounts to Social Security. That's because, and I think you'll have other speakers talking about this so I don't want to take away their speeches. I just couldn't let it go unresponded to even by my dear friend, Rich McGahey, and that is that if indeed Mr. Walker is still talking about [the] need to cut Social Security and we need to protect people at the bottom end and stuff. Any kind of add-on account to Social Security -- if you can afford these additional kinds of contributions to this kind of account -- you can afford to use those extra contributions to save Social Security, not have to make the kinds of cuts and benefits that Mr. Walker is implying.

That's the reason I think Teresa's done a terrific job here of setting out a good plan, but the notion of somehow connecting it with Social Security in a way that allows you to—if we got the money for those contributions and we've got the political will for those contributions and we have the political goal to do something about fixing Social Security, and I know there are people that think that Social Security shouldn't have a surplus, it shouldn't—it can't save money. It's full of worthless IOUs, it's a ponzi scheme and all those awful comments. But it's just if you've got the political will for the extra contributions then it ought to go to Social Security.

TG: You need the political will for a meaningful retirement income security program which needs this basic social insurance program, Social Security, and people need to have a financial instrument that works for them. They need both. These are very different programs. That's the political issue, but if we have the political will to secure retirement security you need both. They are so dissimilar that I can't see that they're substitutes. Let me just add this: Social Security is not—was never a substitute for other kinds of retirement plans. They are compliments. The insurance industry was pleasantly surprised when Social Security passed that it actually added more demand for their annuity products rather than less because you've instilled the retirement idea which is a hallmark of a civilized society.

FS: Professor, I believe you mentioned there would be matching contributions of employers and employees of two and a half percent. Just curious what your thoughts are from the business end of additional burden particularly small businesses that employ so many people.

TG: I'll be straightforward about that. I'm a labor economist, and it's a principle of our creed that workers pay for most of the taxes on them anyway. That that employer contribution of two and a half percent will be paid by employers, but over time it might be depending upon the particular labor market be absorbed through less than hefty wage increases. So I envision that economically the workers would be paying for most of that anyway. However in some periods of time the employer may need to pay that 2.5% just to attract workers. It's not a twelve percent levy. It's only two and a half percent, and it would be paid for with the Social Security taxes that haven't gone up in fourteen years. So I don't see any dis-employment effects.

DW: I think the bottom line is it'll end up resulting in somewhat less real wage growth for a period of time in order to fund it. So basically what you're doing is you'll get somewhat less real wage growth in the short term in order to be able to achieve economic neutrality to be able to fund these accounts for the longer term.

MS: I know this is not the kind of plan where you'd like it taken out and done polling or anything like that, but to go back to Mr. Walker's question about political feasibility, I think I'm one of the few kind of younger people in the room, and if you look at polling data among eighteen to twenty-nine or whatever, people are really strongly against a lot of retirement programs in general for whatever reason if it's media spin or whatever it is. So I don't know if you've thought about the political feasibility and looked at numbers on that.

TG: Yeah, quite a bit. In fact I teach a class called "Do the Old Eat the Young?" at Notre Dame. It's a very popular class. I find out that it's actually easy to talk to younger people about income security because they immediately realize that if their parents and grandparents have income security they're off the hook, and if it's low cost and efficient they are glad to do it. There is some relevant polling. I just mentioned that one bank survey of twenty-one thousand people in twenty countries asking people what they want to do about this. Even in America there is support. In fact it's the most popular option is mandated savings.

So I think we're there. It just takes leadership. That's one of the deficits that Mr. Walker has identified in other places as a political deficit, a leadership deficit, but with just a little bit of explanation of what I think is this hot diggidy dog, common sense proposal. I think that won't be a barrier, that generational barrier won't be probable.

MS: In sort of the history of Social Security every time we've run a surplus with the exception of—every time we've had projected surpluses, that money has been used for more benefits. Assuming stock market or the funds are growing consistently above three percent what makes you think the same isn't gonna happen and there is gonna be political pressure to just increase the yield?

TG: Yeah. There might be some political pressure to increase the yield, but the yield is one of the better ones you can get. I mean that most of us would invest in a 3% guaranteed real return tomorrow if we could. But there has also been a lot of attention to the importance of prudent long-term thinking in these programs, and I think that the idea that the government should protect itself from unending and non-recognized contingent liabilities is with us, will always be with us, and I don't think it'll be great.

DW: I think you'd want to structure it up front so there would be a recognition that there needs to be some reserve fund established and that you might have a corridor approach. The other thing is, is I think one of the things you'd think about is when reserves get to a certain size then that might end up triggering the possibility of declaring a dividend. An analogy I would give you is when I testified before the Congress, the Senate and the House in January and February of 2001 when we had a surplus and when people thought we were actually gonna pay off all the national debt and they were worried about it—we don't need to worry about that anymore that's for sure.

But one of the concepts that I brought to them was modern portfolio theory and what do you do when you've got a projected surplus which may or may not actually happen. One of the concepts that I brought to them was maybe you declare a dividend if it really happens. Alright, which puts pressure on you to be prudent with regard to the budget because one you start declaring dividends people like to continue to get dividends and it totally changes the incentives.

NANCY ALTMAN

RE: Make sure that it's there in its current form with its current benefits. Nancy Altman is our first speaker. She's a lawyer with more than thirty years experience in the area of Social Security and private pensions. She was Allen Greenspan's assistant in his position as Chairman of the 1983 bipartisan commission on Social Security. She's taught courses on retirement income at Harvard Law and is the author of "The Battle for Social Security, From FDR's Vision to Bush's Gamble". Nancy Altman. (Applause)

NA: All of you have heard politicians and pendants refer to Social Security as a problem. Far from being a problem Social Security is a model for the rest of the government. Everyone knows that Social Security's benefits are sent reliably, accurately and on time every month to millions of retirees, widows, widowers, children and disabled Americans. But did you know that after Hurricane Katrina when President Bush famously told Brownie that he was doing a heck of a job, Social Security really was doing a heck of a job. Its representatives were at the Houston Astrodome and other evacuation centers insuring that those people who no longer had homes or access to their bank accounts nevertheless received those benefits on time and even in cash when necessary.

Did you know also that Social Security was the first insurer on the scene after the terrible events of September 11th? Virtually every worker who perished that day was covered. The families of every worker [were] covered by Social Security. In the chaotic aftermath of that tragic day millions of Americans reached into their pockets and generously contributed to the Red Cross and other charitable organizations. But the most immediate, sustained and generous support came from Social Security. The very first benefit checks were sent out just three weeks later on October 3rd, 2001. Today virtually all working Americans continue to contribute to those 9-11 families every payday.

The money that is withheld from your paycheck is put into the Social Security's Old Age and Survivors Trust Fund out of which those 9-11 families receive benefits still today. Social Security is a model in other ways as well. Politicians talk about family values. Well Social Security is all about protecting America's families. Its dependent benefits make it the nation's largest children's program. Another example of Social Security's model behavior; everyone has heard about fraud, waste and abuse in the government. In contrast, Social Security operates smoothly and efficiently, returning in benefits more than ninety-nine cents of every dollar collected, spectacularly greater efficiency than you will find in any private sector retirement plan or any private insurance.

Another example of its prudent management is its long range forecasts. Every year Social Security publishes a trustee's report which projects anticipated income and expenditures over, as you all know, three-quarters of a century. The purpose is to provide a very early warning of potential problems, and it works. Since 1961 the federal government not including Social Security has registered a deficit every year but two. In stark contrast, Social Security, which is prohibited from deficit spending, has never missed a payment. While the rest of the federal government is projected to spill 1.7 trillion dollars of red ink over the next decade, Social Security is projected to have accumulated a 4.5 trillion dollar surplus.

Now many pundits speak as if they've just realized the baby boom will retire, but Social Security's actuaries have been thinking about it since those boomers were born. The trustees' report of 1947 took into account the babies born in 1946. The trustees' report of 1965 recognized the full size of the entire baby boom. The trustees' reports of the early 1970s projected the very change in worker to beneficiary ratio that President Bush mentions so frequently in his push for private accounts. Congress has enacted ten significant Social Security bills since 1950. Every single one of those enactments took into account the baby boom and every single one left social security in long range balance.

An irrational cry of alarm has accompanied the recent trustees' reports which project a long range deficit. Rather than a cause for alarm the fact of a projection that reveals a manageable deficit decades away is a sign of the program's prudent management and should give Americans confidence in the future of Social Security. Numerous ways exist to close this very manageable deficit. In a minute I'll tell you what I think is the ideal solution. But let me start by telling you what should not be done. Under no circumstances should Social Security's benefits be cut. Modest though they are they are a necessity, indeed a lifeline, to most beneficiaries who receive them.

And though most Americans don't realize it, those benefits, as I think many of you know, are being cut right now under current law. Furthermore, cutting Social Security's benefits makes no sense. Indeed it's counterproductive given what's happening in the rest of the retirement income system. Employer sponsored retirement plans which even at their height never covered more than about half the workforce, are growing increasingly less available and less adequate and they have never been tremendously secure. The weakness of those plans increases the importance of Social Security and underscores the need to, at the very least, maintain those benefit levels.

So what should we do? Social Security can be restored to close actuarial balance over the full seventy-five year valuation period with three modest proposals. Each is sound policy in and of itself deserving enactment even if there were no projected shortfall. First, the maximum taxable wage base should be returned to the sound practice of capturing 90% of aggregate wages in covered employment. Let me explain what I mean. Social Security has always from it's beginning included a maximum wage base. The vast majority of workers throughout its history have always earned less than the maximum which in 2007 is $97,500. I'm happy in the question and answer period if people are interested to go through the reasons for having that base.

The important point here though is that past Congresses have intended that that base capture 90% of all wages in covered employment. That is if you take the wages of every single worker covered by Social Security across the entire country and you look at them compared to the maximum taxable wage base the intent is that 90% of those wages fall underneath the base and are within the Social Security system and only 10% are above the base and outside the system. In 1977 when Congress indexed the entire program it intended to make permanent that 90% practice. It did so by having that maximum increase every single year by the average growth in wages nationwide.

The problem is that automatic adjustment hasn't worked the way it was intended. Because the wages of the highest paid workers has grown much more rapidly than average wages over the last several decades the adjustments have not kept pace and the maximum has not done its intended job. Currently only about 84% of total wages are captured by the base and subject to withholding. That seemingly small slippage from 90% to 84% has made a tremendous difference. It involves billions and billions of dollars each year. So my first proposal is Congress should restore the practice of collecting Social Security contributions on the full 90%. To do so all at once however would create a big, new expense because you're catching up a lot of years a big new expense for those earning just above the maximum.

Fortunately the Social Security deficit can be cut by a full one-third even when that 90% mark is phased in extremely gradually, in fact over a period of decades. Under this proposal, as I would phase it in, the most any high-paid worker would experience in any given year is simply one additional week of withholding further into the year. If this proposal had been law this year in 2007 again the most any worker earning over $97,500 would contribute extra in Social Security is $116.81, and those workers earning above $97,500 contributing that extra $117 or so and their families would earn higher Social Security benefits as a result of that extra contribution.

Of course the vast majority of workers would be totally unaffected. So that's the first proposal. Second, I believe the estate tax should be converted into a dedicated Social Security tax. As many of you know, President Bush has advocated the permanent repeal of the federal estate tax. I believe as a fundamental matter the estate tax should be preserved as a matter of principle. A tax upon the transfer of great wealth from one generation to the next reinforces the democratic ideal of Ameritocracy. Moreover, the accumulation of large estates always depends in part on the general productivity of the American economy and on the nation's infrastructure requiring the very wealthiest Americans to contribute a part of their fortune to the common good seems a reasonable imposition on those who have benefited so greatly from America's opportunities and from the common wealth.

But why dedicate it to Social Security? There is a powerful policy justification for dedicating that revenue. From the startup of the program, policymakers made the reasonable decision that the then recent generation of retirees should receive a meaningful benefit from Social Security even though they didn't have enough years under the system to contribute even close to what the value of those benefits would be. Social Security's costs have never been amortized. This unpaid legacy - debt incurred to help a past generation of Americans - should start being paid at least in part from a progressive tax rather than exclusively from the wages of employees and from their employers.

And the estate tax, the nation's most progressive tax, fits the bill perfectly. It is a tax on legacies to pay a legacy debt. So that's two. Third, just as virtually every other pension plan, Social Security should be permitted to diversify its portfolio and invest in stocks as well as bonds. In proposing individual accounts President Bush sought to capture for beneficiaries of Social Security the historical higher returns from investment inequities. Allowing Social Security to invest some of its accumulating reserves in broad-based, index stock funds under a variety of safeguards - including the proxy voting that we've just talked about - would allow the capture of these same returns but without the risk to individuals. Individual retirement income would continue to be based on wage records not on the vagaries of the stock market.

These three proposals, restoring the maximum to 90 percent, dedicating the estate tax, the social security and diversifying social security's portfolio will restore social security to close balance. The next step… we have a huge health problem, but the next step in the retirement income security issue would be to increase social security's benefits. If we want a guaranteed, sure-fire way to insure that all Americans can enjoy retirement following a lifetime of labor, the fairest, simplest, most secure, most efficient, most effective way is simply to expand social security, a program that has stood the test of time.

That's the next subject of the next presentation to which I now commend your attention, thank you very much. [APPLAUSE]

RE: Our next speaker, Virginia Reno, has written extensively on social security. I first heard her at a presentation up on the Hill and was very impressed. We asked her to do something unusual for both I guess the National Academy and for Virginia herself, which is to chart out possibilities for how you would do what Nancy Altman just discussed, how you would actually improve American's retirement security by expanding social security. She is the Vice President for Income Security at the National Academy of Social Insurance, please welcome her. [APPLAUSE]

VIRGINIA RENO

{VIEW Reno's PowerPoint Presentation)

VR: Thank you Ross, it's a pleasure to be here today and I'm… delighted to be the last in this panel of speakers. I should emphasize as Ross suggested, I'm speaking only for myself, not for my organization but it's also the case that what I'm talking about builds on work that we have done at the Academy, including on the affordability and adequacy of current retirement income. And quite frankly, also on the difference between insurance and savings accounts and our real premier on that issue is this big fat book that we did in 2005.

But it tried to explain the difference between savings accounts and social insurance. I'm delighted that EPI is holding this conference because it's changing the kinds of questions we've been asking and that is, how do we actually improve the adequacy of retirement income? It's been my experience that too often when we look at savings, pensions and social security in isolation we say, "How can we fix up pensions? How can we have more incentives for savings? …and, How will we reduce social security to make it more affordable and [more] adequate?"

And I think looking at all these pieces together is a real improvement. I will briefly make these points today. First, I will argue that social security is affordable, benefits are modest yet they're terribly important to the elders who receive them and we'll have some facts on that. There is a case for more adequate retirement income and I think Teresa and Nancy have also touched on that. I will also make the case for using social security to deliver that more adequate income and talk about construction of retirement income in the 21st century.

On the question of affordability, I find it helpful to talk about affordability in terms of the share of the entire economy that is represented by social security benefits. Today it is 4.3 percent. It is scheduled to rise to 6.2 percent when all the baby boomers are retired, in about 2030. But then it's scheduled to remain at about that level of the entire economy for the rest of the project period, to 2085 and perhaps beyond. That growth, that 1.9 percent of the entire economy, is less than the increase in spending that we incurred when baby boomers were children and we spent it on public education.

So, and furthermore, when baby boomers showed up to enroll in kindergarten, they were a surprise. Their retirement is not, as Nancy and Teresa have already noticed. This is just a picture of what social security does in terms of replacing prior earnings of workers. These are retirement benefits, the replacement rates are relatively modest, these are under current law, at 65 an average earner gets about 40 percent of prior wages, a low earner gets a little over half. A higher earner earning about $60,000, benefits replace about a third and for one earning up near that cap… the replacement rate is closer to about a quarter, a little over a quarter.

These are fairly modest. Furthermore, these are the benefits if you retire at 65. If you take them early, they're reduced below these levels, you're getting down into the 30 percent range for many workers. The average benefit for retirees now is about $1000 - $1050 a month, or roughly a little over $12,000 a year. Not a generous income in and of itself, but the important point is how, despite the fact that benefits are not great, they are a very large share of the total income of most retirees and that will be the point of the next chart, which is hard to read, but it's also on page eight of the paper, "Building on Social Security Success."

So you have that with you. The point here is that this looks at the elderly population divided up into five equal groups based on their total income. The two top pies are the two lowest income groups, both together they have income less then $16,000 a year and social security is the blue/lavender part of those pies. It's more then 80 percent of their total income, everything else is quite small. For the middle income group, with income between about $16 and $26,000 a year, social security is two-thirds of their total income.

In this group the magenta is pensions from both public employment and private employment. Pensions are beginning to have a bigger role in this middle group, but account for just 17 percent of total income. The lower pie on your left -- this is the upper middle income group, people with between about $26,000 and about $45,000 in total income. Nearly half of their income is from social security. For this group pensions are getting up to become about a quarter of their income. After pensions are earnings, that pale yellow group or piece of pie.

The light blue is income from assets, that's income from wealth. And that little skinny slice is everything else. Only when we get to the top income group, that group with total income of over about $45,000 is social security not the largest source, but it's instructive to look at why. Pensions are about the same size as social security, the largest source is earnings, because these people are not retired yet. So this is not necessarily indicative of where they might be when and if they finally do retire from the workforce.

The key point here is simply that social security is very important to retired Americans not just the low income, though it's critical for them but way up through the middle and upper middle of the income distribution. The case for more adequate benefits: I think both Teresa and Nancy have touched on these issues, but I will talk about them very briefly. First, in the United States replacement rates are low by international standards, and there are data in the paper that compare replacement rates in the United States with those in other OECD countries. Our average earner gets about 40%. The average among OECD countries is over 55%.

Second, U.S. seniors are more likely to be poor than are elders in many European countries, and here we use a measure of poverty based on international comparisons. That is having income less than half of the median income for similar sized households. For those seniors in the United States fully 25% are counted as poor by those standards. If you look at women living alone beyond 65 in the United States almost half, 46%, fall below this measure of income adequacy. Both of these observations based on the data are talking about the current situation and the situation we've known for income of the elderly has been fairly stable in the United States for twenty-five years in a relative way.

But the next point is that Social Security replacement rates will be less adequate in the future, and that's for two reasons. First, the little known, I think little known realization that if back in 1983 when the Greenspan Commission's rec—actually it wasn't their recommendation. When Congress raised the age for receiving full benefits from Social Security, that, in effect, is a benefit reduction at each age that people take retirement benefits. So as that full benefit age goes from sixty-five to sixty-seven between about the year 2000 and about 2025 that's equivalent to a twelve to fourteen percent cut in benefits at each age they're claimed.

The other reason why replacement rates will be less adequate in the future is more subtle, but also relates to a point that Mr. Walker pointed out and that is healthcare costs are rising. While Medicare is an important expenditure in the federal budget it's also an important expenditure for the beneficiaries. Those Medicare premiums come directly out of Social Security benefit checks. So as Social Security keeps up with the cost of living those premiums go up with the cost of healthcare and take a bigger and bigger bite out of Social Security benefits.

Finally we have the observation that DB pensions are much less likely to be there for future retirees than has been the case in the past. The next question: So all of these developments suggest we need more retirement income, but why improve Social Security instead of creating a new system? This is an area where we may disagree, but I would like to make the case for why not build on Social Security? And I would say primarily because it already exists. It has virtually all the features of an ideal retirement plan for working families and it has some insurance features that other types of approaches don't have.

First of all it covers almost everybody, and it's fully affordable between jobs. When I say it covers everybody it covers people who were never thought of as part of the pension world. That is it covers part-time, temporary, contingent workers. It covers self-employed individuals. It covers farm workers. It covers household employees, domestic workers and so forth. It covers everybody. It pays benefits that last for life, that keep up with the cost of living. And they automatically, in response to one of the questions, Social Security automatically continues benefits for people widowed in old age so that what a widowed person receives relates to what the couple had been receiving before and that doesn't necessarily happen in other systems.

There's family life insurance and disability protection that are critically important, that are the basis of the benefits to families that Nancy talked about. It has a permanent sponsor, that is the government. It's not gonna take its operations overseas completely. As Nancy said, it's very efficient in terms of administrative costs. I would make the case that insurance is somewhat different from a savings account, even a forced savings account, and that people need both a solid, firm foundation of insurance and they need savings on top. There is a case for maintaining some sort of voluntary savings in the United States.

I'm not sure that it needs to be heavily subsidized, but it's a very good thing for people to have. Social insurance, as Social Security provides it, targets all the protection to specific risks. In the case of Social Security the loss of income due to disability, retirement or living a long time in old age and the loss of a spouse's income in old age. It doesn't protect other things. None leaked out in bequests or withdrawals for emergencies or for education or for purchase of a home or medical expenses and so forth. This makes Social Security different from what Americans expect of a savings account. At the same time savings accounts have features that are not found in Social Security.

You have choice about how you use the money in most cases, at least the kind we've known so far. You own the money and as such you can spend it however you wish. You may have to pay tax penalties but you can still spend the money if you wish. You can decide how the money is used, and you can make bequests. These features make savings accounts popular. They also fill very important purposes. But they're different from Social Security. They're different from insurance. So I would argue that for the 21st century we clearly need a very strong foundation of social insurance both for retirement and for other risks that families face. We also need an important role for voluntary savings on top.

The tradeoffs between forced saving and social insurance as mandatory protection I think are something that merit much more discussion. I think they're very intriguing ideas and because we haven't been talking about improving retirement income we haven't been talking about tradeoffs about how to do that. But I think the time has come to do that. [APPLAUSE]

Q & A SESSION

DW = David Walker; TG = Teresa Ghilarducci; NA = Nancy Altman; VR = Virginia Reno; RE = Ross Eisenbrey; MS = Unidentified Male Speaker; FS = Unidentified Female Speaker

RE: We've asked the Comptroller General to ask the first questions of this panel. He has other business and will be leaving, but we've given him the first shot at our ardent defenders of Social Security. So David.

DW: I agree that Social Security is probably the most successful government program we have. It also has broad-based support within society. I'll stipulate that, and we need to make sure that we make it sustainable and secure indefinitely, not just for seventy-five years when we do the next set of reforms. We shouldn't be pre-programmed to have to come back as we were last time. I do think that you ought to consider Social Security reform as an add-on or extension of that as possibly one means of trying to be able to achieve this.

Here's my concern. We have a thirty-two trillion dollar hole for healthcare. If we're gonna need more revenues, and I think we will increase the taxable wage base. I think we will do that to moderate whatever reforms otherwise might be necessary for Social Security. If we need more revenues I think they're gonna have to be targeted to healthcare because the concern that I have is if you look at Social Security standing alone it's not a really big problem to solve. It really isn't that big a problem. It's the easy one. But because it is not that big a problem we need to keep in mind that whatever we do in Social Security you can't spend the money twice. But at least you shouldn't spend the money twice.

So my question is like for example when you say do something with the estate tax and dedicate it to Social Security I get concerned about that because if we're gonna dedicate any additional revenues to anything it probably ought to be for healthcare.

NA: Well let me say first I absolutely agree with you about healthcare, and healthcare people should understand it's not a government problem. It's not a Medicare/Medicaid problem. It's a healthcare system problem. Henry Aaron has done very interesting work on that. It's unsustainable for the private sector as well as it is for the government. So that's an issue that we've got to address comprehensively. It's not a problem of the aging of the workforce. It's a problem of the increase in healthcare costs. I agree with you, that's a higher priority. My plan—the maximum taxable wage base is a modest change that I'm talking about. Permitting the capture of investment in the stock market is not a new expenditure. It's just getting more return. The estate tax part of what's intriguing to me about the estate tax is today's politicians seem ready to give it up. It barely escaped repeal before 2006, and I think there is substantial likelihood that it might get used for no purpose. It might simply be eliminated.

So if we are gonna keep it, there is a policy justification for having it—for having some progressive taxation for Social Security to pay these legacy costs, and it seems to me we can retain the estate tax by having a powerful counterpoint. If you say to politicians are you voting for Social Security or are you voting for repeal of the estate tax it's a much harder question than well your big contributors want to get rid of the estate tax and nobody else pays it. So why don't we get rid of it? So some of it is a political concern.

TG: I guess I would certainly not disagree with you at all about the importance of the healthcare dilemma. I guess in terms of affordability I like thinking about the cost of Social Security as well as the cost of healthcare as a share of the entire economy. One of the striking things about Social Security's tax base, revenue base, is that taxable wages are only 38% of the total economy. The rest of the economy is income to people that is not taxed for Social Security purposes. So I think it makes a lot of sense given that everybody gets the benefits that we think beyond the Social Security tax base to income from wealth, income above the cap, to non-taxable compensation which is of course not politically popular but all of those health benefits that are never considered part of income to workers and so forth.

On the question of affordability we also say in our paper that really is in large part a question of what we're willing to pay for and how much we're willing to pay. I was struck in looking at some recent data comparing the United States with other OECD countries. We're second from the bottom in terms of the share of our GDP we pay in taxes. Only Mexico and Korea pay less. The tax rate—state, local, federal, all together—is about 25% in the United States. It's about 35% for all the other OECD countries including those two who are below us.

MS: Nancy, I'm a little concerned about the proposal to invest in equities. The logic would carry over to all the government trust funds—civil service, military retirement—and if we're going to tap what are basically arbitrage gains why don't we just borrow a lot and invest it in the market irregardless of the Social Security trust funds?

NA: Most other trust funds do invest in equities. The Federal Reserve Board pension plan does. The TVA pension plan does. Canada's retirement income plan does. Many state and local plans invest in equities. So of course we want to have safeguards and so forth but we have reserve. Part of the answer—the program has been pay as you go for much of its history, but Mr. Walker has made the point, and I think it's the right point, that we've got this permanent shift in the cost. So what I think we need is to have a permanent reserve. But part of the cost of Social Security should be paid from earnings from that reserve just the way it is kind of an advance funded plan.

So all I'm saying is that some of that interest or dividend income should come not just from treasury bonds but also should come from equities.

FS: Do you think it's necessary to solve the Social Security problem for seventy-five years and beyond?

NA: Well, I think as they say the forecast of a projected deficit which may or may not materialize, and we're talking about projecting immigration rates, fertility rates, workforce participation of women, productivity, all kinds of things that go into this forecast which is why we don't make these projections for the rest of the government. I mean imagine if we projected our defense spending for the next seventy-five years and tried to figure out how we were gonna pay for it which is what we're doing with Social Security.

But I do think it's part of the prudent—and let me say one other thing about the seventy-five years. That is a much longer valuation period than any private sector plan, and indeed it is a longer projection period than most other countries. The only other country I know that projects out seventy-five years is Canada and that's because they came here and looked at our plan and copied ours. So it is a very long projection period. The idea of it is that a worker just starting joining the workforce at age twenty or so will at age—in seventy-five years be ninety-five. So it covers a worker's entire working period and retirement period.

Again it's an emphasis on the prudent management, and yes I think it makes sense to take those intermediate assumptions and to get at least into close actuarial balance, which is what this proposal does. We've got a long lead time, and we should be trustee's reports every single year. But again the thing that's frustrating for me is that it seems to me that should give Americans confidence in the program, but the confidence has been undercut by all the charges that it's going broke.

TG: Just very briefly on that question to solve—I mean I would agree with Nancy it's good to take a long range view. But the very nature of a defined benefit system is that it's going to need to be adjusted from time to time because nobody can predict the future with certainty. The only way you can avoid ever making any future adjustments is to have a defined contribution plan where workers bear all the risks. So if you've got a defined benefit you've got to adjust it from time-to-time, and Congress should be prepared to do that.

MS: Thanks. I'd like to ask the question of people living longer which seems to be according to statistics now. But what about people working longer as a possible, not total solution, the problem of Social Security?

NA: Let me make a couple points. On the people living longer there's also a lot of misinformation on that. Longevity has definitely increased. But the right statistic to look at is not life expectancy from birth, but life expectancy at age twenty or life expectancy at age sixty-five. Because the reason we've had such dramatic increases in longevity is because in the 20th century we wiped out a lot of childhood diseases and that's what's caused that. People who lived to age twenty fifty years ago lived a few years shorter, on average, than people who live to age twenty today.

But it's not these dramatic you know fifteen, twenty years that's talked about. In terms of people working longer, I think there should be a choice, but we should be very clear that cutting Social Security's benefits or raising the retirement age so that—the way Social Security works you get the actuarial equivalent no matter when you retire. So that as Virginia said that if you cut—if you raise the retirement age from the perspective of Social Security it's exactly the same as an across the board cut for retirees. What that does is people work longer because they can't afford to retire. It's not that they're being—it sounds like a work incentive program.

I think the bigger issue is the private sector which still has a fair amount of subsidized early retirement and promises a retiree health but then disappears. I think it's fine for people to work longer if they choose to, and if there are incentives for them to do so. I don't think people who are in jobs where it's very tough to keep working should be required to.

RE: I'd like to take the moderator's prerogative and add that the fact that people live longer doesn't say anything necessarily about their ability to work, their health status. You can live a long time with a not very good quality of life. You can live a long time unable to do the work that you were doing. The evidence I think Teresa might have the figures on this. A lot of people who are retiring are retiring not by their own choice. They're pushed out of work by their employers. They're laid off. They can't find another job. The ability of older people to work is not automatic by any means.

FS: Hi. My name's Jackie Simon. I'm from the American Federation of Government Employees. On behalf of our members who work in the Social Security Administration I want to thank you both for all your kind words about the way the Social Security system is administered. But I wanted to ask another question about public investment of the trust fund versus private investment of the trust fund. I see General Walker just left, but I think he said earlier he contrasted public investment with equity investment referring to equity investments as real investments as opposed to public investments which I've always understood as being just as real. Certainly a claim on the U.S. Treasury is a real equity.

But I also—Professor Ghilarducci referred to the idea in her plan that there would be absolutely no public input in the sense of socially attuned investment standards. When we invest our retirement savings publicly we all have a say through voting in how those monies are invested. They're invested in the public sector. The jobs created—again, I come from a public sector union—the jobs created through public investment are usually pretty good jobs. They have health insurance, they have retirement benefits and they have decent wages, wages that are at least above minimum wage and provide a living wage.

So there are a lot of reasons to prefer public investment over private investment aside from the rate of return which is by no means guaranteed in the private investment but we know is guaranteed in the public sector. So I just wanted you to comment on that if you will.

NA: Well I'm really glad you made the point about investment in Treasury bonds as a real investment. When President Bush went down to West Virginia and opened the file drawer and said these are just worthless ideas. I kept saying can I have them? If I had 4.5 trillion dollars of Treasury bonds I'd be quite—you could even give me one trillion. I'd be very happy. So it is an important point that these are reserves that are real investments. The problem is because it's Social Security which is administered by the federal government and the trustees lending money to the general budget with interest being paid back it gets confused in the public's mind.

So you often hear at town hall meetings people saying they're stealing our money. The federal government has not been very good about investing in infrastructure and those kinds of things as opposed to transfer kinds of things. So the bulk of the money still should be invested in Treasury bonds. Under the proposal that I'm advocating there would be a cap of about fifteen or twenty percent that would be invested in the stock market. But I still think it makes sense to diversify it and to have for a lot of reasons to have at least a small part of that money invested in equities.

MS: Teresa, or she's been referred to as the professor's plan, is funded in large part by reclaiming tax expenditures that I think pretty clearly have failed as a way to increase savings in retirement security. I was struck that unless I missed it neither of you really made a claim on those resources as a way of funding an expanded Social Security system. I wonder why not?

TG: There have been a number of proposals to revamp those tax expenditures for savings to make them more progressive, more equitable, more fair, and probably more effective. If we end up with a system of stronger social insurance and some voluntary savings on top it would make sense to reorganize those tax expenditures. Keep them for the purpose of perhaps tax credits for savings as opposed to the tax deductions that now so heavily favor the well-to-do. But I do think it's also very worthwhile to look beyond the narrow Social Security tax base for the revenues we need for retirement security. I think that base it too small to do the job.

MS: Thanks. Nancy mentioned that if we lifted the cap to 90% that we would solve a third of the current funding problems long term in Social Security. But that's only part of the effect that growing inequality of wages has had on Social Security financing. The upper income whose wages have grown very fast are escaping the tax altogether, but there's stagnation at the median which means that the average contribution is lower than it otherwise would be. I wonder if you've made an estimate of the extent to which both ends of inequality would impact the operating deficit of Social Security, and if we fixed the inequality of wages so that wages were rising at the rate of productivity again, which I know is the ambition of EPI and their shared prosperity project, what part of the problems of financing for Social Security would we address in that way?

NA: I think that's a fabulous question, and I think some research needs to be done on that. I don't have the answer, but it's a perfect, excellent question. Let me say that's the kind of thing that the actuaries are looking at, and that's why as I say we should not react with alarm every time a trustee's report comes out showing decades away a deficit. As you know, the actuaries make three sets of assumptions, and under one of their still realistic but what's called—often referred to as the optimistic assumption, there is no problem over the 75 year period.

So if you project further out increased productivity in the middle and—I mean, increased wage growth in the middle and less wage growth at the top, you may not have the problem that the actuaries are now projecting that we may have.

MS: Hi. Thanks. On the bond issue and whether it's worth anything, the late Robert Eisner always used to say, "Imagine your Aunt Tillie dies and gives you the key to her strong box. You open it up and it's full of treasury bonds." Do you say, "Oh, my God, I'm bankrupt", you know? But maybe a clarification, and this is much to Teresa's point about the social investment point. I think the point she was making was an ERISA type standard that said you couldn't make investments that would be below a risk-adjusted market rate of return.

That doesn't mean that you wouldn't invest in public bonds, in public infrastructure. You could, and, in fact, you would, in a balanced portfolio, have investments in bonds that would include things for public infrastructure. You just wouldn't be allowed to take a lower market rate of return. I assume in part—some part that's a political judgment about how to present the program.

RE: In the projections that we did with our actuary on Teresa's plan, in fact, it assumed a 70/30 equity or 60/40 bond—equity and bond distribution of the…

RE: Right. It could be in lots of different kinds of… Right.

FS: Virginia, your paper has several ideas laid out for improving social security benefits, some of which would be across the board, some of which would be targeted. Since you are still speaking here as an individual, could you elaborate on some of the ideas you think are most important?

VR: Sure. Actually, I had one final slide. [LAUGHTER] I think it is important to be asking the right question about how do we ensure retirement security, and we look briefly at across-the-board increases. If you are willing to raise enough revenue, this five percent of taxable payroll (which is not necessarily the base I would choose for all of it come from), that could finance about a 30% increase in social security benefits across the board. There are also options for improving benefits for low income people, for people with lifetime low income.

There are proposals for improving survivor benefits, particularly with widowed spouses in dual earner couples, which now at least get less adequate benefits as widows in old age than other groups do, than do single earner couples do. I mean, there are a lot of very good ideas. I think the important thing is to begin that discussion with people who've thought about the social security improvements a lot and look at them towards the goal of income adequacy.

Social security's a complicated program but it's important to get the goals right. Figure out how you're gonna pay for it. How are you gonna phase in the benefits? How are you gonna phase in the costs? That's the research that needs to begin. So thank you for the question. And I think this is the beginning of the conversation and I don't necessarily have the answers yet.

RE: Is there a last question? If not, then thank you very much. And please thank the panel members for their presentation. [APPLAUSE] And you can all go to the website for the Agenda for Shared Prosperity in a day or two and the video and audio will be up and a transcript will follow. Thank you.

END OF TAPE