SOCIAL SECURITY BRIEFING BOOK FOR MRS. CLINTON

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for
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BACKGROUND ON SOCIAL SECURITY

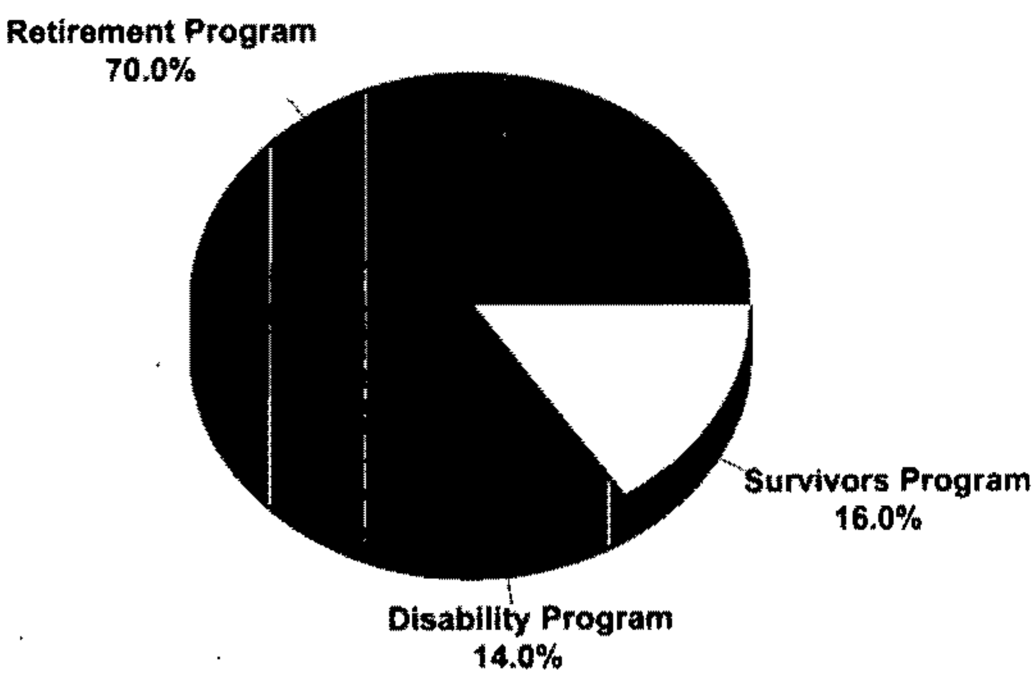
- **<u>Social Security is more than just a retirement program</u>.** It also provides disability insurance (in case an individual becomes disabled and can't work) and survivors' insurance. Each is equivalent, for the average young family with two children, to an insurance policy of about $300,000 ($600,000 in total).

  - Nearly one-third of Social Security's 44 million beneficiaries are either disabled or survivors (or their dependents).

  - 3.8 million children receive benefits: 1.9 million as survivors of deceased parents; 1.4 million as children of disabled workers; and 0.4 million as children of retired workers.

Social Security Is More Than A Retirement Program

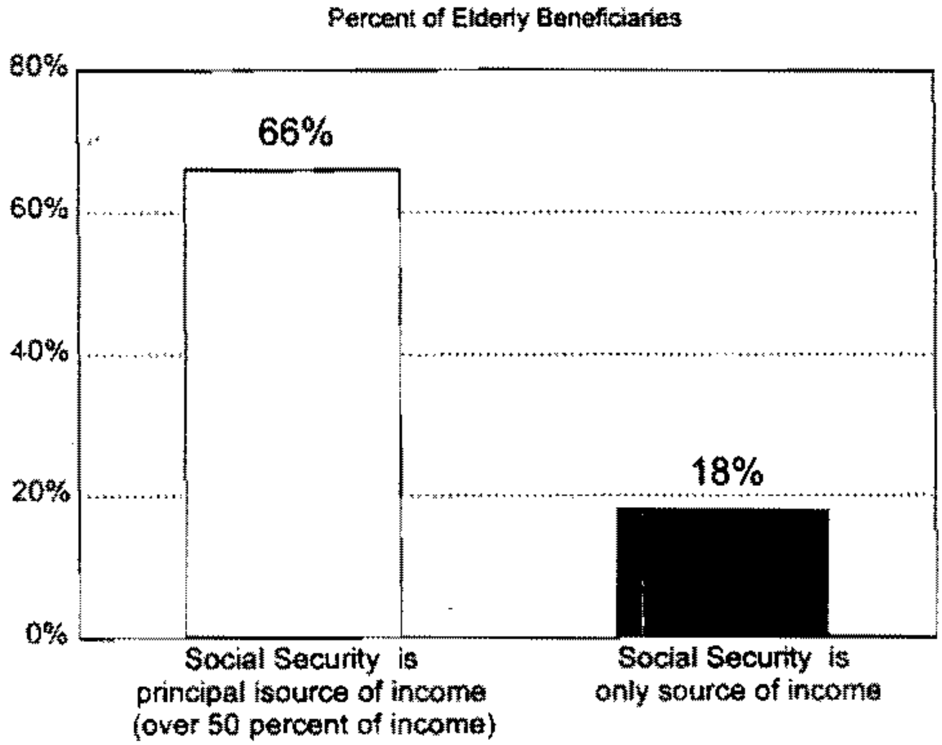
Percentage of Social Security Beneficiaries By Program



- **<u>Social Security provides a benefit you can count on.</u>** A Social Security benefit is both guaranteed for life after retirement <u>and</u> indexed to inflation.

- **<u>Social Security is a crucial source of income for the elderly.</u>** Social Security benefits represent the majority of income for two-thirds of elderly beneficiaries, and are the *only* source of income for 18 percent of its elderly beneficiaries.

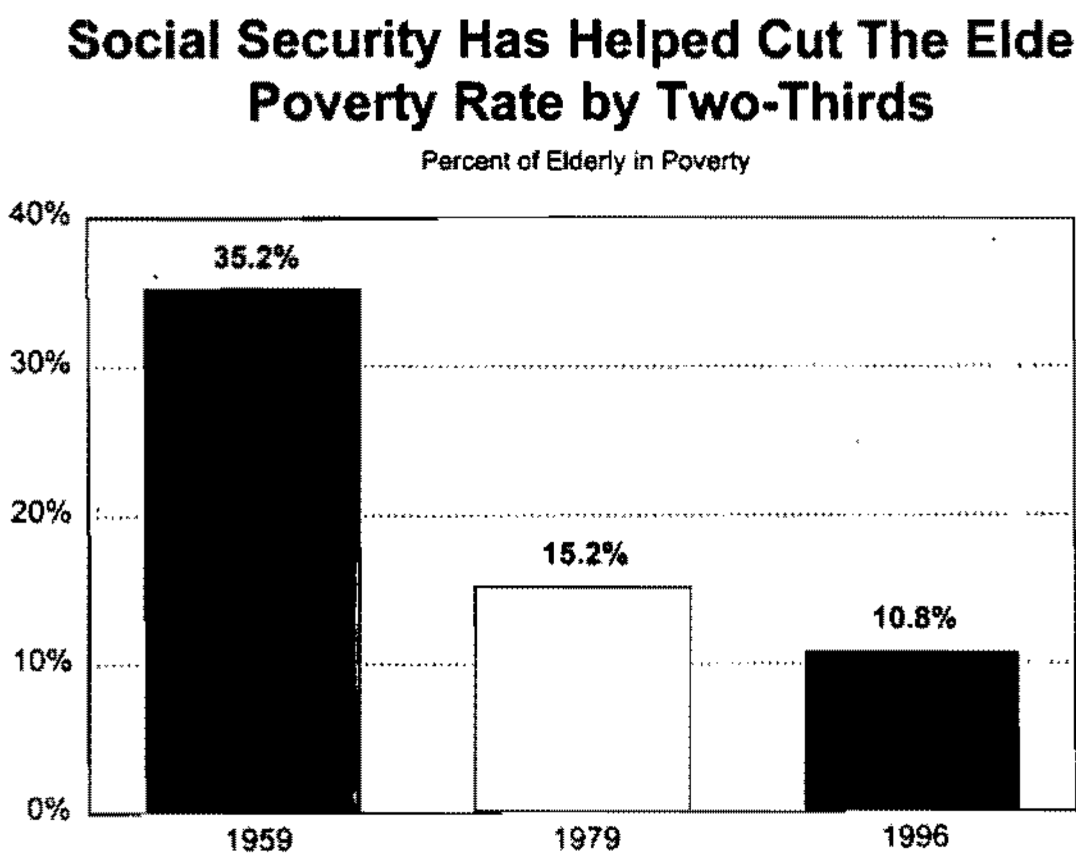
Social Security Is Crucial Source of Income for the Elderly



- **Social Security has dramatically reduced the rate of poverty among the elderly.**

    - The elderly poverty rate has fallen from more than 35 percent in 1959 to 10.8 percent in 1996.

    - Even today, with our strong economy, the elderly poverty rate without Social Security would be 48 percent. Social Security benefits lift roughly 15 million elderly Americans out of poverty (and another 1 million non-elderly Americans out of poverty).



- **Social Security is especially important to women.** For single, divorced, or widowed elderly women, the poverty rate would be 60 percent without Social Security (relative to 20 percent with Social Security). Because women live longer, they are more likely to outlive savings and other non-Social Security sources of retirement income.

- **Average Benefits.** The average monthly benefit for a retired worker is $760. The average monthly benefit for a retired worker with an aged spouse is $1280.

- **Share of US Budget.** Social Security outlays are expected to be $378 billion in FY 1998, 23 percent of the total U.S. budget of $1.67 trillion, and 4.5 percent of GDP.

FIVE PRINCIPLES FOR SOCIAL SECURITY REFORM

At the Kansas City conference, the President enumerated five general principles to guide Social Security reform. The principles are:

1. **Strengthen and Protect Social Security for the 21st Century.** This principle provides our overall goal in reforming Social Security and warns against proposals that are not comprehensive solutions to the solvency problem.

2. **Maintain Universality and Fairness.** This principle is designed to ensure progressivity, and preclude an opt-out option (which would unduly benefit upper-income Americans).

3. **Provide a Benefit People Can Count on.** This principle precludes radical privatization, which would undermine Social Security as a foundation of retirement income security.

4. **Preserve Financial Security for Low-income and Disabled Beneficiaries.** This principle highlights disability and survivors' insurance, as well as protection for low-income widows and other beneficiaries -- which are often overlooked in reform discussions.

5. **Maintain Fiscal Discipline.** This principle is intended to ensure that the surpluses are not drained before addressing Social Security reform, and that we maintain our fiscal discipline in order to prepare for the retirement of the baby boomers.

WHY DO SOCIAL SECURITY REFORM NOW?

- Perceived and real insolvency of Social Security system threatens confidence in crown-jewel of progressive government -- particularly among younger Americans.

- Acting now will prevent the budget surplus from being dissipated on tax cuts which would leave fewer resources to fix Social Security later without resorting to significant benefit cuts or revenue increases.

- Waiting longer will make reforms within more traditional Social Security structure more painful and more difficult because the actuarial imbalance will be greater and surpluses will be smaller or even unavailable, which could erode confidence in the system and lead to more radical and painful reform down the road.

- Reform is necessary to keep spending on the elderly from crowding out other desirable spending in the middle of the next century.

- Acting now will help build confidence in the system among younger Americans, who may not have as solid a commitment to the New Deal social compacts as older Americans.

ENSURING SOCIAL SECURITY REMAINS PROGRESSIVE

Maintain and Strengthen Social Security's Progressivity

- The current Social Security benefit structure is highly progressive.

REPLACEMENT RATES (Annual Social Security Benefits/Average earnings during working years)	
Low Earner ($12,000)	57 percent
Average Earner ($27,000)	43 percent
Maximum Earner ($68,400)	25 percent

Social Security reform must protect this structure and make progress toward achieving other progressive goals.

Reduce Elderly Poverty

- Social Security has played a large role in reducing elderly poverty from 35.2 percent in 1959 to 10.5 percent today.

- Social Security reform could help further reduce poverty rates among the elderly, particularly among widows and elderly people of color.

PERCENT IN POVERTY, PEOPLE AGES 65 AND ABOVE				
	Married	**Widowed**	**Divorced**	**Never Married**
Women	4.6%	18.0%	22.2%	20.0%
Men	4.6	11.4	15.0	22.8

PERCENT IN POVERTY, PEOPLE AGES 65 AND ABOVE			
	White	**Black**	**Hispanic**
Women	11.7%	28.9%	28.1%
Men	6.0	22.2	23.6

FOUR OFTEN-MENTIONED WAYS TO SOLVE SOCIAL SECURITY'S FUNDING PROBLEM

- **Use Budget Surpluses.**
- **Reduce Benefits.**
- **Increase Traditional Revenues.**
- **Invest in Equities.**

BACKGROUND ON DEMOGRAPHIC TRENDS

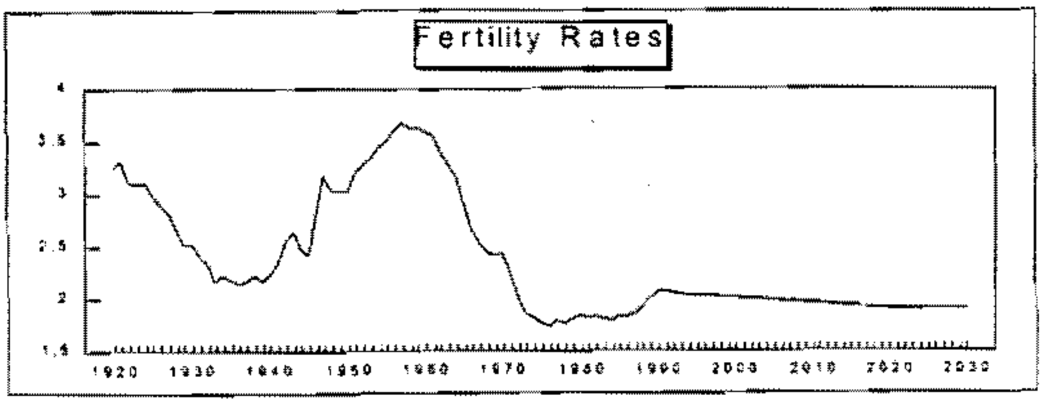
AMERICANS ARE LIVING LONGER THAN IN THE PAST:

The challenge of financing the retirement of the baby boomers and of future generations of retirees is largely the result of good news -- people are living longer.

LIFE EXPECTANCY AT AGE 65			
Year turning age 65	**Male**	**Female**	**Total**
1940	12.0	13.7	12.9
1998	16.2	19.8	18.1
2030	17.7	21.1	19.4

FERTILITY RATES REMAIN LOW

During the coming century, fertility rates are expected to fall below 2 births per woman.



- The figure above shows the high fertility rates of the babyboom years and the lower subsequent rates.

- While the retirement of the baby boom generation will intensify these trends, increasing longevity and declining fertility would have produced a financing problem for Social Security even if there had not been a post-war baby boom.

	1940	1950	1960	1970	1980	1990	2000	2020	2040	2060
Total fertility rates (births per woman)	2.23	3.03	3.61	2.43	1.85	2.07	2.01	1.91	1.90	1.90

AMERICANS ARE RETIRING EARLIER THAN IN THE PAST:

- In 1950, nearly half (46 percent) of men 65 and older were in the labor force. Today only 16 percent of men 65 and older are in the labor force. In 1950, 10 percent of women 65 and over were in the labor force, while 8 percent participate today.

- Over the past 3 decades, the percentage of Americans who receive Social Security retirement benefits before age 65 has increased dramatically.

PERCENTAGE OF FIRST RECEIPT OF RETIREMENT BENEFITS BY AGE				
Year/Age	62	63-64	65+	TOTAL
1962	18	19	63	100
1996	60.1	18.3	21.6	100

EXPLANATIONS FOR WHY PEOPLE ARE RETIRING EARLIER THAN IN THE PAST:

- Social Security has made it possible for more elderly to afford to retire. In particular, the introduction of the early retirement age in 1961 (1956 for women) has enabled people to retire before age 65.

- Rising incomes have made it possible for some people to afford to retire even before they are eligible for Social Security.

- Private pension plans can create incentives to retire early.

- Society's attitude toward the appropriate age of retirement may have changed.

THE HEALTH OF THE ELDERLY IS IMPROVING, BUT SOME PEOPLE WORK IN PHYSICALLY DEMANDING JOBS:

- In a recent survey, one-quarter of retirees said that poor health was the most important reason why they retired.

- The percentage of workers approaching retirement who work in physically demanding jobs has been declining and is expected to decline further in coming decades. However, there remains a segment of the population, particularly the lower paid and African Americans, who tend to work in these physically demanding jobs.

- Estimates of the percentage of workers approaching retirement who are in physically demanding jobs range from 11 percent to over 30 percent depending on the definition used.

- Even jobs that do not involve heavy physical labor -- kindergarten teaching for example -- can be difficult for older workers.

Overall Impact: Declining Workers per Beneficiary

Increased longevity, reduced fertility, and early retirement imply a falling ratio of workers to beneficiaries. The ratio of workers to beneficiaries was 5.1 in 1960 and is 3.4 today. It is expected to fall below 2 in 2035 and reach 1.8 by 2065.

	1950	1960	1970	1980	1990	2000	2020	2040	2060	2070
Workers per beneficiary	16.5	5.1	3.7	3.2	3.4	3.3	2.4	2.0	1.9	1.8

- Similar trends are occurring around the world. As the chart below shows, many countries are aging much more rapidly than the U.S.

RATIO OF PEOPLE AGE 65 AND OLDER TO PEOPLE AGES 20 TO 64
(In percent)

	1990	2010	2030	2050
Japan	19.3	35.8	48.7	60.1
Germany	23.6	32.9	53.8	57.5
France	23.4	27.2	43.1	48.4
Italy	24.3	33.8	52.4	66.7
United Kingdom	26.7	28.6	42.8	45.8
Canada	18.6	22.9	43.6	46.5
United States	20.8	21.3	35.5	37.0

LONG-TERM FINANCING PROJECTIONS

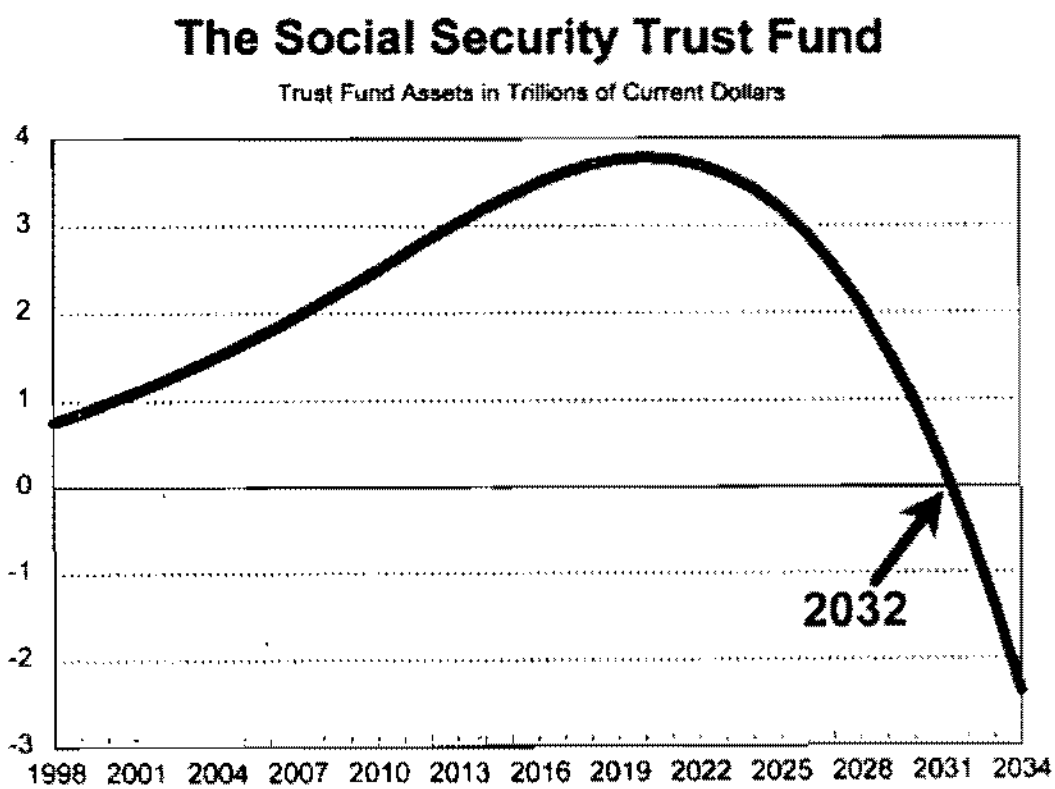
The Social Security system is expected to face increasing strains as the nation's nearly 80 million baby boomers retire, as life expectancies continue to increase, and as the fertility rate declines. There are currently 3.4 workers who contribute to the system for every Social Security beneficiary. By 2030, there will be only 2 workers for every Social Security beneficiary.

According to the intermediate projections of the Trustees:

- By <u>2013</u>, payroll contributions (plus income taxes on benefits) will not be sufficient to pay for benefits due under current law. In order to meet its benefit obligations, the system will have to begin spending some of the interest it earns on the assets in the Trust Fund.

- By <u>2021</u>, taxes plus interest earnings will not be sufficient to pay for benefits, and the Trust Funds will begin declining, gradually at first, and then more rapidly.

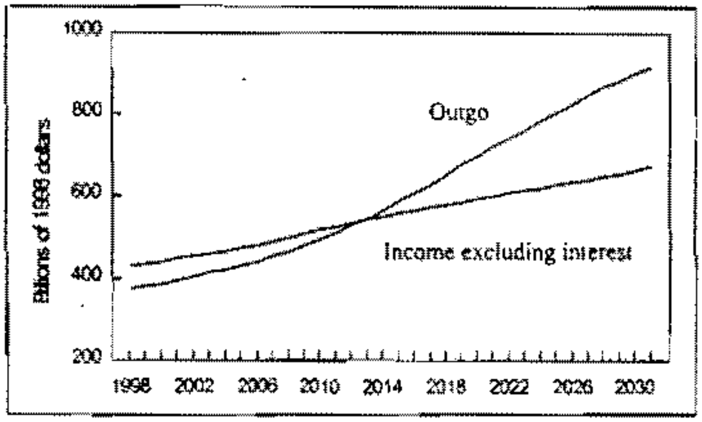
- By <u>2032</u>, the Trust Fund is expected to be depleted -- at which time income to the system would still be sufficient to pay about 75 percent of current law benefits.



OUTLOOK FOR SOCIAL SECURITY FINANCING

Beginning in 2013, Social Security Spending will Exceed Social Security Taxes

Since the 1983 reforms, Social Security has been taking in more revenue in payroll taxes and from the taxation of benefits than it has been paying out in benefits and administrative costs. As the demographic factors described above take effect, this situation will reverse itself and beginning in 2013 Social Security will begin paying out more than it receives in taxes.



- Social Security outgo and income are often expressed as a percentage of payroll. This measure illustrates the amount payroll taxes would need to be increased to restore pay-as-you-go balance if no other changes were made.

OASDI Income and Cost Rates, Calendar Years 2000-2070
(As percentage of taxable payroll)

	Income rate (Social Security Revenue as percentage of taxable payroll)	Cost rate (Social Security outgo as percentage of taxable payroll)	Balance
2000	12.63	11.16	1.48
2010	12.74	12.19	0.54
2020	12.92	15.17	-2.26
2030	13.10	17.76	-4.66
2040	13.18	18.13	-4.95
2050	13.22	18.29	-5.07
2060	13.29	19.04	-5.75
2070	13.34	19.54	-6.20

MEASURING LONG-RUN ACTUARIAL BALANCE

Each year, the SSA Trustees' Report presents estimates of the financial status of the OASDI program for the next 75 years. For the system to be in actuarial balance, the present value of income into the system must exceed the present value of costs. These summarized income and costs measures are presented as a percentage of the present value of taxable payroll over the 75 year period.

OASDI Income and Cost Rates for 75-year Period			
	Income rate	Cost rate	Actuarial balance
1998-2072	13.45	15.64	-2.19

- In the 1998 Trustees' Report, OASDI was found to have an actuarial deficit of 2.19 percent of payroll.
- This 2.19 deficit can be interpreted as the increase in annual payroll taxes necessary to bring the system into exact actuarial balance. For example, if the 75-year actuarial deficit of 2.19 percent were addressed by raising scheduled tax rates by 2.2 percentage points (1.1 each for employers and employees), then OASDI assets at the beginning of 1998, together with income from payroll taxes, interest, and other sources, would be just sufficient to meet all expenditures for the long-range period and leave the level of the trust fund at the end of the period equal to about 100 percent of the following year's expenditures.
- Restoring 75-year actuarial balance is a common goal of reform plans.

Different Solvency Goals

While achieving 75-year actuarial balance is the standard target for reform plans, some have argued that this goal alone may not be sufficient.

For example, if actuarial balance were achieved by raising the payroll tax by 2.19 percentage points, Social Security would run many years of surpluses in the beginning of the 75 year period followed by many years of deficits at the end of the period. While the trust fund would have 1 year's worth of benefits in the 75th year, the trust fund would be declining and the system would not be able to pay full benefits on time soon after the 75th year. **An important implication of reform plans that achieve 75-year balance with good years followed by bad years is that the passage of time alone will bring the system out of balance in the future. In the worst case scenario, one year after reform, the system would no longer be in 75-year balance.**

Therefore, some proposals attempt to achieve actuarial balance over periods of more than 75 years. Others aim to have a stable or growing trust fund at the end of the 75th year.

Nonetheless, it is worth noting that even if a reform plan achieved only 75 year solvency, it would be making Social Security much stronger than it is today -- pushing back the exhaustion date of the trust fund by 40 years.

OUTLOOK FOR THE UNIFIED BUDGET

FOR THE NEXT DECADE SOCIAL SECURITY IS RESPONSIBLE FOR MOST OF THE UB SURPLUSES

Both OMB and CBO are projecting large unified budget (UB) surpluses over the next decade. Until 2002, the non-SS budget is in deficit, but Social Security surpluses lead to a unified budget surplus. In later years the on-budget surplus is positive as well.

Budget Projections						
	CBO July 1998 (Billions of dollars)			OMB Mid-session Review 1998 (Billions of dollars)		
	Unified Budget	Non-Social Security	Social Security	Unified Budget	Non-Social Security	Social Security
1998	63	-41	104	39	-63	102
1999	80	-37	117	54	-59	113
2000	79	-46	125	61	-62	123
2001	86	-45	131	83	-48	131
2002	139	1	138	148	6	142
2003	136	-10	146	150	-2	152
2004	154	0	154	184	24	160
2005	170	5	165	213	36	177
2006	217	44	173	245	60	185
2007	236	55	181	300	103	197
2008	251	64	187	342	.136	206
1999-2008	1548	31	1517	1780	194	1586

- Social Security is responsible for 89 percent of the 10-year unified budget surpluses under OMB projections, and 98 percent of the 10-year UB surpluses under CBO projections.

Illustrative Budget Projections (Numbers for 2010 and beyond are for illustrative purposes only.)			
	(Billions of dollars)		
	Unified Budget	Non-Social Security	Social Security
2000	79	-46	125
2005	170	5	165
2010	About 280	About 250	About 30
2015-2020*	About 470	About 600	About -130

* *For illustrative purposes, annual average for time period*

- In 2013, Social Security outgo begins exceeding Social Security tax revenue. In order to pay benefits, the Social Security Trust Fund begins redeeming its bonds and receiving funds from the general fund. Nonetheless, current long-run projections have unified budget surpluses persisting beyond 2020 because the non-Social Security budget surpluses are larger than Social Security's shortfall.

OASDI INCOME AND COST PROJECTIONS FROM TRUSTEES' REPORT
(Billions of Dollars)

	Income excluding interest	Outgo	Balance
1998	435	383	52
1999	450	396	54
2000	468	413	55
2001	488	433	55
2002	509	455	54
2003	532	478	54
2004	557	504	53
2005	585	533	52
2006	614	565	50
2007	648	599	49
2008	682	637	45
2009	718	679	39
2010	756	724	32
2011	795	773	22
2012	835	826	10
2013	877	884	-7
2014	920	946	-26
2015	965	1014	-49
2016	1011	1087	-76
2017	1060	1165	-106
2018	1110	1249	-139
2019	1162	1337	-175
2020	1217	1430	-214

SOCIAL SECURITY TAXES

- **<u>The Old-Age, Survivors, and Disability Insurance (OASDI) program is funded by a tax of 12.4 percent of earnings,</u>** split equally between the worker and employer (self-employed workers pay the entire 12.4 percent themselves). An additional 2.9 percent tax is used to fund part of Medicare.

- **<u>The OASDI tax is levied on the first $68,400 of earnings</u>** (this threshold is indexed to average wages in the economy).

  -- Unlike the federal income tax which has deductions and exemptions that imply that very low-income people pay no tax, the OASDI tax begins on the very first dollar of earnings.

  -- Social Security's progressive benefit formula offsets its regressive tax structure.

- **<u>The OASDI program receives additional revenue from the partial taxation of Social Security benefits.</u>**

  -- For those with income above $25,000 if single and $32,000 if married, up to 50 percent of Social Security benefits are taxable. The income taxes on these benefits are credited to the Social Security Trust Funds.

  -- For those with income above $34,000 if single and $44,000 if married, up to 85 percent of Social Security benefits are taxable. The additional revenue from taxing benefits at 85 percent rather than 50 percent is credited to the Medicare trust fund, not the OASDI trust funds.

  -- In calendar year 1997, only 25 percent of beneficiaries were subject to taxes on their Social Security benefits.

- During fiscal year 1997, income to the OASDI trust fund was composed of:

Payroll tax contributions	$398.5 billion
Income from taxation of benefits	$ 6.9 billion
Interest income	$ 41.2 billion
Total income	$446.5 billion

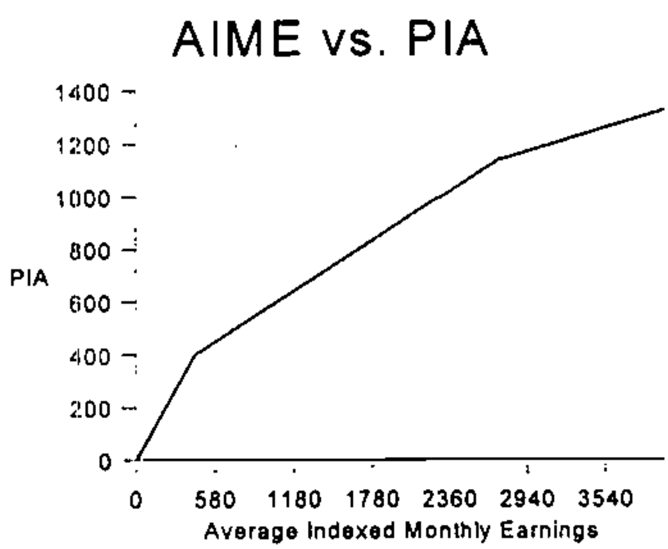
SOCIAL SECURITY BENEFITS

- **<u>The Social Security benefits received by a worker are based on the average earnings of the worker over his or her lifetime.</u>** Each year of earnings is indexed to the increase in the average annual wage between the year of the earnings and the year the worker turns 60.

- **<u>The benefit formula takes the highest 35 years of indexed earnings and averages them</u>**. This average is divided by 12 to provide a worker's Averaged Indexed Monthly Earnings (AIME).

- **<u>A progressive benefit formula is applied to the AIME to produce a worker's Primary Insurance Amount (PIA)</u>**, which is the level of monthly benefits a worker is entitled to based on his or her own work history if the worker retires at the normal retirement age of 65.

For a worker becoming eligible in 1997, the PIA is calculated as:



90 percent of the first $455 of AIME
+ 32 percent of the next $2286 of AIME
+ 15 percent of AIME above $2741

- **<u>This formula implies that a worker with higher lifetime earnings receives a higher Social Security benefit, but that the share of a worker's average earnings that is replaced by Social Security falls with income</u>**.

Replacement rates

Low earner ($12,000)	57 percent
Avenge earner ($27,000)	43 percent
Maximum earner ($68,400)	25 percent

Benefits for Married and Previously Married Beneficiaries

- Married couples receive 150 percent of the PIA of the higher earner in the couple or the sum of the PIAs of the two spouses, whichever is larger.

- Widows and widowers receive 100 percent of the PIA of the higher earner in the couple.

- Divorcee benefits are available to people if their marriages lasted at least 10 years. A divorced person receives the larger of the benefit he or she is entitled to from his or her own work history and 50 percent of the ex-spouse's benefit if the ex-spouse is still alive and 100 percent of the ex-spouse's benefit if the spouse is deceased.

DISABILITY BENEFITS AND SURVIVORS BENEFITS

Disability Benefits

- **Eligibility.** An insured worker who cannot engage in any kind of substantial gainful work because of physical or mental impairment is eligible for disability benefits if the disability is expected to last for at least 12 months or to result in death.

  -- To be an insured worker, the worker must have received credit for half of the calendar quarters during the previous 10 years and one-fourth of the calendar quarters since the worker turned 21. Currently a worker receives a credit for every $700 of earnings, up to $2800, earned during a year.

  -- Substantial gainful work is defined as the ability to earn $500 a month.

- **Benefit calculation.** For a worker who becomes disabled before age 56, fewer than 35 years are used in calculating worker's average indexed earnings. The number of computation years is the number of years elapsed since age 21 minus a number of drop out years that depends on the worker's age. Then, the same PIA formula that applies to retired workers is applied to the disabled worker's AIME.

- **Benefits are also payable to members of the disabled worker's family.** In addition to the benefit for the disabled worker, a benefit equal to 50 percent of the worker's benefit is payable to the worker's spouse if he or she is at least 62 or is caring for one or more of the worker's children (the children must be under 16 or disabled). Each dependent child (under 19) of the worker is also entitled to a benefit equal to 50 percent of the worker's benefit. However, the total benefit received by the family is limited to the smaller of 150 percent of the disabled worker's PIA and 85 percent of the worker's AIME.

Example

The family: A married couple with two young children in which both the husband and wife are 27 years old, the husband earns $28,000 (the average earnings in the economy), and the wife doesn't work.

Disability Benefits: If the husband becomes disabled, this family will receive disability benefits of $17,500 a year. This is equivalent to a payout of $300,000 from the disability insurance policy.

Survivors Benefits

- **Eligibility.** Survivors' benefits are payable to the spouse and dependents of a covered worker after the worker's death.

  -- A widow(er) receives benefits if the widow(er) is age 60 or older or age 50-59 and disabled. The widow(er) receives a benefit equal to 100 percent of the worker's PIA if he/she is disabled or if he/she takes benefits at age 65 and receives reduced benefits if he/she is not disabled and takes benefits earlier.

  -- A mother's/father's benefit equal to 75 percent of the worker's PIA is payable to a surviving spouse who is not married and is carrying for at least one child age 16 or below of the deceased worker. Each child (under 19) of the deceased worker is also entitled to a benefit equal to 75 percent of the worker's benefit. However, the total benefit received by the family is limited to between 150 and 188 of the disabled worker's PIA depending on the level of the worker's PIA.

Example

The Family: A married couple with two young children in which both the husband and wife are 27 years old, the husband earns $28,000 (the average earnings in the economy), and the wife doesn't work.

Survivors' Benefits: This family will receive survivors' benefits of $20,400 a year. This is equivalent to a payout of $330,000 from a life- insurance policy.

The Social Security Retirement Age

- **The normal retirement age is currently 65, but workers can retire as early as 62, with reduced benefits.** Beneficiaries receiving widow/er benefits can retire as early as age 60, again with reduced benefits.

  -- For retired workers, benefits are reduced by 6 2/3 percent for every year before 65 that a worker elects to receive benefits. Thus a worker retiring at age 62, receives a monthly retirement benefit for the rest of his or her life that is 20 percent lower than the benefit he or she would have received if he or she had waited until age 65 to receive benefits.

  -- Spouses and widow(er)s also have their benefits reduced for early retirement.

- **The 1983 reforms gradually raise the normal retirement age to 66 for workers who reach age 62 in 2005.** The retirement age begins increasing by 2 months per year starting in 2000, reaching 66 in 2005. Then the retirement age will remain at 66 until 2016, when it will begin increasing gradually again until it reaches 67 in 2022. The earliest eligibility age will remain 62.

  -- The normal retirement age for someone who is 54 years old today is 66.

  -- The normal retirement age for someone who is 37 years old today is 67.

- **Workers who delay retirement beyond age 65 receive credit for postponing the benefits.** The 1983 Social Security Amendments gradually increased the delayed retirement credit. A worker reaching age 65 in 2007 will receive an 8 percent increase in benefits for every year he or she delays receiving Social Security beyond age 65.

The Social Security Earnings Limit

- **Historically, Social Security has been a program for those who are retired**. The 1935 report of the Committee on Economic Security appointed by President Roosevelt recommended that no benefits be paid before a person had "retired from gainful employment." Various forms of earnings limits have been part of the program as a way to restrict benefits to retirees.

- **Currently, Social Security recipients who are between the ages of 62 and 69 have their benefits reduced if their earnings exceed a certain amount.** The benefits of recipients who are aged 70 or above are not affected by the limit.

  -- Recipients under 65 lose $1 of benefits for every $2 of earnings above $9,120.

  -- Recipients between 65 and 69 lose $1 of benefits for every $3 of earnings above $14,500.

- **On average, recipients get back these lost benefits through the delayed retirement credit** which provides them with increased benefits once they stop working. Nonetheless, many elderly workers perceive the earnings test to be unfair and as an impediment to work.

- **In 1996, working with both Democrats and Republicans in Congress, President Clinton signed into law annual increases in the earning limit for those between 65 and 70.** Between 1998 and 2002, the limit for workers in this age range will increase from $14,500 to $30,000.

- **Because benefits foregone are given back through the delayed retirement credit, eliminating the earnings limit would have almost no effect on the long-run actuarial balance of the OASDI program.** Such a change would have significant short-run budget effects, however. Removing the earnings limit for those aged 62 and above would raise Social Security expenditures by roughly $12 billion in 2001.

COVERAGE OF THE WORKFORCE

- **96 percent of all jobs in the United States are covered by Social Security.** Since the Social Security Act of 1935, coverage has expanded from workers in business and industry to include the self-employed, nonprofit groups, agricultural and household workers, the Armed Services, Congress, and all other Federal employees hired after 1983. In 1998, 96 percent of all workers are covered under Social Security -- up from 55 percent in 1939.

- **25 percent of State and Local Government Workers are not covered by Social Security.** State and local government employees are the final sizable group of workers not universally covered by Social Security. If such workers are mandatorily covered under a state or local public pension system, they are not mandatorily covered under Social Security. Roughly 25 percent of state and local workers are not covered under Social Security (A total of 5.5 million workers). 75 percent of these are in 7 states: California, Ohio, Texas, Illinois, Massachusetts, Louisiana, and Colorado.

- **The most common occupations of uncovered workers are teachers, firefighters, and police.**

- **Many workers who worked in non-covered jobs still receive Social Security benefits.** 95 percent of noncovered state and local workers receive SS as workers, spouses, or dependents. Some have their benefits reduced under the government pension offset and windfall elimination provisions.

- **Almost every Social Security reform plan calls for including newly hired State and Local Government workers in the system.** All 3 Advisory Council plans included such a provision, and do the Ball plan, the Moynihan-Kerrey plan, and the NCRP (Breaux-Gregg Kolbe-Stenholm) plan.

  -- Covering all new hires immediately solves about 11 percent of the 75-year actuarial imbalance. Allowing a 10-year lead time, this provision would solve 8 percent of the problem.

  -- Those who favor this provision say it is only fair for the last sizeable group of uncovered employees to be covered. Since most of our Social Security taxes go to pay benefits for our parents and grandparents, all workers should share in this burden.

  -- Those who oppose this provision say that it is unfair to require state and local governments to redesign their pension systems, and that either benefit levels for state and local government workers will fall or costs to state and local governments will rise if this provision is adopted.

- **<u>COLAs Affect Millions of Americans</u>**. The cost-of-living adjustment within Social Security is set each year on the basis of the increase in the Consumer Price Index (CPI) over the year ending in the third quarter of the previous year. Cost of living adjustments (COLAs) affect 44 million Americans through the Social Security program, and millions more through other programs (including the tax code). The CPI is calculated by the Bureau of Labor Statistics (BLS).

- **<u>Boskin Commission Concluded that the CPI overstates true change in cost of living.</u>** Michael Boskin chaired the "Advisory Commission to Study the Consumer Price Index" which reported to the Senate Finance Committee on December 4, 1996. The Commission estimated that the CPI overstated the true rate of change in the cost of living by between 0.8 and 1.6 percentage points per year, with a best estimate of 1.1 percentage points per year. While most economists agreed with the Boskin Commission that the CPI is biased upwards, there is considerable uncertainty about the magnitude of the bias.

  The commission concluded that the CPI is biased upwards for a number of reasons, the most important of which are:

  Substitution bias. As the prices of goods and services change, consumers tend to shift their spending away from items that have become relatively more expensive. Such shifts are not reflected in the CPI because it uses a fixed basket of goods and services.

  Quality change bias. The quality of many goods and services changes over time. The BLS attempts to correct for these quality changes as best it can, but many experts believe that some quality improvement slips through nonetheless.

  New product bias. New products often are not introduced into the market basket in a timely manner, causing the index to miss the typical initial phase of price decline.

- **<u>BLS is Making Improvements</u>**. The Bureau of Labor Statistics is continuing to make improvements in the CPI, and many economists believe that they are making good progress. Alan Greenspan recently testified that the "[BLS has] done really an excellent job over the last couple of years." Recent technical changes will lower CPI inflation by an estimated 0.3 percentage points per year going forward. These changes are already incorporated in the forecasts of the Social Security Actuaries. Changes scheduled for 1998 and 1999 will likely have a relatively small impact on Social Security's finances. Any major additional changes beyond these would likely require legislation instructing Social Security to use a different index for its COLA adjustments.

- **<u>COLA will be 1.3 Percent</u>**. Recent COLAs have been relatively small because inflation has been low. The COLA payable in the January 1999 benefit check will be 1.3 percent for OASDI benefits..

- **<u>Impact on Social Security Reform</u>**. Reducing the COLA by 1 percentage point per year reduces lifetime benefits for the average retiree by roughly 10 percent, and reduces the long-run actuarial imbalance in the Social Security system by 1.4 percent of taxable payroll (out of current gap of 2.19 percent).

SOCIAL SECURITY ADMINISTRATION

The Social Security Administration (SSA) is one of the best run organizations within government.

- **High on Customer Surveys.** Surveys of SSA's customers have shown that the agency gets consistently high marks from its customers for prompt, courteous, and accurate service whether they are dealing with one of SSA's local offices or with the 800 Number Service.

- **SSA's 800 number has been rated better than almost any other public or private sector toll-free number service**, including such well-known services such as the L.L. Bean catalog. (SSA's 800 number is 800-SSA-1213). In fiscal year 1997, the Social Security Administration served over 55 million individuals who called the 800 number, making it one of the largest toll-free service systems in the world. SSA's achievements in this area have been recognized by Dalbar Associates, an independent auditing agency.

- **Very Efficient: Costs are Less than 1 Percent of Benefits.** SSA is noted for its efficient and effective service. SSA's administrative costs are less than 1 percent of benefit payments.

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- **Women Have Lower Income in Retirement than Men -- And Thus Higher Poverty.** In 1997, median income for elderly unmarried women (widowed, divorced, separated, and never married) was $11,161, compared with $14,769 for elderly unmarried men and $29,278 for elderly married couples. Thus, the poverty rate for elderly women was higher than that of men: in 1997, the poverty rate of elderly women was 13.1 percent, compared to 7.0 percent among men. Among unmarried elderly women, the poverty rate was significantly higher -- about 19 percent.

- **Social Security Is Particularly Important to Women.** Elderly unmarried women -- including widows -- get 51 percent of their total income from Social Security. Unmarried elderly men get 39 percent, while elderly married couples get 36 percent of their income from Social Security. For 25 percent of unmarried women, Social Security is their only source of income, compared to 9 percent of married couples and 20 percent of unmarried men. Without Social Security benefits, the elderly poverty rate among women would have been 52.2 percent and among widows would have been 60.6 percent.

- **Women Face Greater Economic Challenges in Retirement.** First, women tend to live longer: a woman who is 65 years old today can expect to live to 85, while a 65 year old man can expect to live to 81. Second, women have lower *lifetime* earnings than men do. And third, women reach retirement with smaller pensions and other assets than men do.

- **The Current Social Security System Has a Number of Features That Help Women Meet These Challenges.**

    1. Social Security provides an inflation-protected benefit that lasts as long as you live. Since women tend to live longer than men, they are in greater danger of outliving their other sources of retirement income; but it is impossible to outlive one's Social Security benefit.

    2. The progressive benefit formula provides a higher replacement rate for workers with lower earnings. For the median female retiree, Social Security replaces 54 percent of average lifetime earnings, compared with 41 percent for the median male.

    3. Social Security provides extra benefits to spouses with low lifetime earnings. The Social Security spousal benefit helps many women, even if they did not work at all outside the home.

    4. Social Security provides benefits to elderly widows; 74 percent of elderly widows receive benefits based on the earnings of their deceased spouse.

    5. Social Security provides benefits to spouses of any age who care for children under 16 if the worker (other spouse) is retired, becomes disabled, or dies; women represent 98 percent of recipients receiving benefits as spouses with a child in their care.

- **Social Security Will Continue to Be Important for Women in the Future.** As the labor force participation rates of women continue to rise, women in the future will reach retirement with much more substantial earnings histories than in the past. Therefore, the percentage of women receiving benefits based solely on their own earnings history is expected to rise from 37 percent today to 60 percent in 2060. However, this means that 40 percent of women will continue to receive benefits based on their husband's earnings.

- **Poverty Rates Among Unmarried Elderly Women -- Especially Widows Who Make up 45 Percent of All Elderly Women -- Are High.** Divorced women are a growing share of the elderly population, and their poverty rate is higher than the overall elderly poverty rate. And finally, poverty rates among elderly minority groups are unacceptably high.

- **Among Current Retirees, Women Have Much Less Pension Coverage Than Men.** Only 30 percent of all women aged 65 or older were receiving a pension in 1994 (either worker or survivor benefits), compared to 48 percent of men.

- **Pensions Received by Women Are Worth Less than Those Received by Men.** Among new private sector pension annuity recipients in 1993-94, the median annual benefit for women was $4,800, or only half of the median benefit of $9,600 received by men. And among women approaching retirement, pension wealth is much smaller: for example, single women had average pension wealth that was 34 percent of the single men's average.

- **Among Workers, Women's Pension Coverage Depends on Work Status.** Overall, fewer women workers have pensions through work, 40 percent of women compared to 44 percent of men. However, women in full-time jobs are equally likely to have pension coverage as men; in 1997, 50 percent of women in full-time jobs had pensions compared to 49 percent of men. It is important to note, though, that women are much more likely to work part-time or be out of the labor force than men.

WOMEN AND RETIREMENT SECURITY

Over the course of this year, the Administration, Congress, and other interested parties have engaged Americans in a national debate about ways to strengthen Social Security for the 21st Century. President Clinton and Vice President Gore attended three bipartisan Social Security forums convened by the AARP and the Concord Coalition, and the President and Vice President hosted a conference on private retirement savings in July. One issue that has arisen repeatedly throughout this process is the relationship between Social Security and women's retirement security. The purpose of this report is to inform the national debate by presenting some of the key facts and issues about women and their Social Security benefits and pensions.

I. BASIC FACTS ON WOMEN AND RETIREMENT

- **Women Have Lower Income in Retirement than Men Do.** In 1997, median income for elderly unmarried women (widowed, divorced, separated, or never married) was $11,161, compared with $14,769 for elderly unmarried men and $29,278 for elderly married couples.[1]

- **Poverty Rates Among Elderly Women Are Higher Than Rates Among Men.** The poverty rate among Americans age 65 and over has fallen from 35.2 percent in 1959 to 10.5 percent today. The poverty rate for all elderly women was 13.1 percent in 1997, compared to a 7.0 percent rate for all elderly men.[2] And for unmarried elderly women, the poverty rate is even higher -- around 19 percent.

POVERTY RATES OF THE FEMALE POPULATION 65 AND OVER BY MARITAL STATUS, 1997[3]

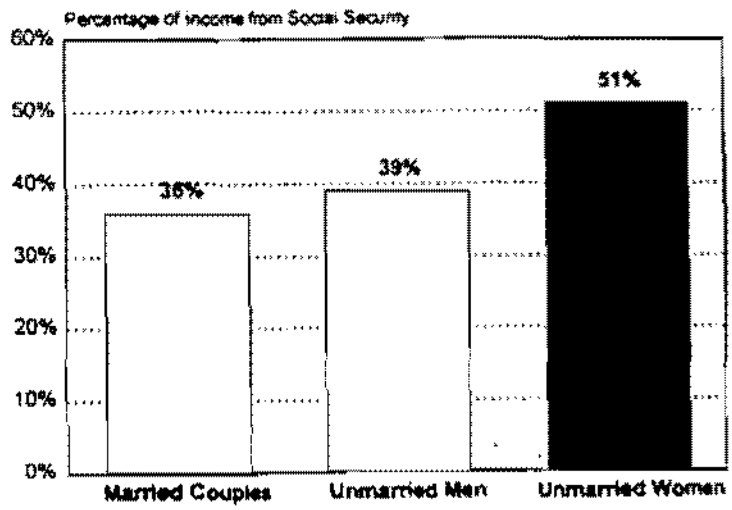
All Elderly Women	Married	Divorced	Widowed	Never Married
13.1%	4.6%	22.2%	18.0%	20.0%

- **Nearly 60 Percent of Elderly Women Are Unmarried.** The poverty rate among unmarried women is particularly important because 59 percent of elderly women are either widowed (45 percent), divorced (7 percent), separated (2 percent), or never married (5 percent). In contrast, only 27 percent of elderly men are unmarried.[4]

- **Social Security Is Particularly Important to Women.** Elderly unmarried women -- including widows -- get 51 percent of their total income from Social Security. Unmarried elderly men get 39 percent, while elderly married couples get 36 percent of their income from Social Security.[5] .

Sources of Income for Persons 65 and Over, 1996 (percent of total income)					
	Social Security	Pensions	Income from Assets	Earnings	Other
Unmarried women	51%	15%	20%	10%	4%
Unmarried men	39	22	16	19	4
Married couples	36	20	18	25	1
All elderly	40	18	18	20	4

Social Security Is Particularly Important For Elderly Women

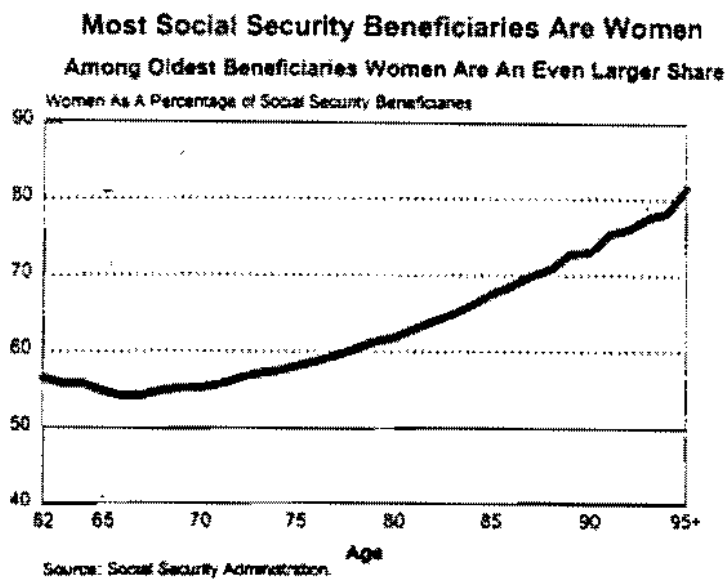


Source: Social Security Administration

II. Social Security and Women

- **Most Social Security Recipients Are Women.** Women represent 60 percent of all elderly Social Security recipients (women are 18.9 million of the 31.7 million aged beneficiaries).

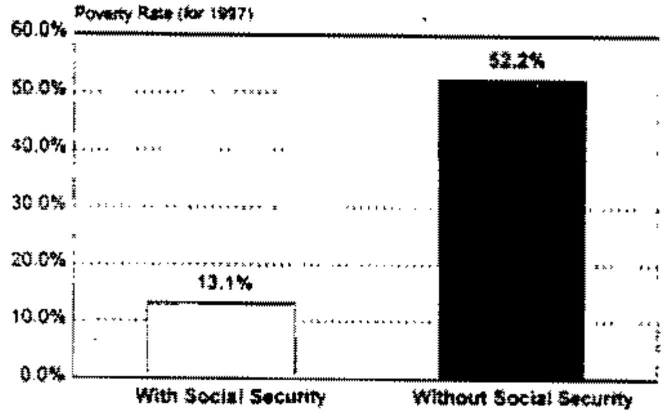
- **Women Make Up Nearly Three Quarters -- 72 Percent -- of the Increasing Number of Americans Over 85 Years Old.** Because women live longer, on average, than men, women make up 72 percent of all beneficiaries age 85 and above.[6]



- **For Many Elderly Women, Social Security Is Their Only Source of Income.** For 25 percent of unmarried women (widowed, divorced, separated, never married), Social Security is their only source of income. Social Security is the only source of income for 9 percent of married couples and 20 percent of unmarried men.[7]

- **Excluding Social Security Benefits, the Poverty Rate among Elderly Women Would Be More Than 50 Percent.** In 1997, the poverty rate among elderly women was 13.1 percent. Without Social Security benefits it would have been 52.2 percent. For elderly widows the poverty rate was 18.0 percent; without Social Security benefits it would have been 60.6 percent. (For elderly men the rate is 7.0 percent, without Social Security it would be 40.7 percent.)[8]

Without Social Security, More than Half of Elderly Women Would Be in Poverty



Source: Social Security Administration.

Why Women Face Greater Economic Challenges in Retirement

- **Women Live Longer than Men.** A woman who is 65 years old today can expect to live to 85, while a 65 year old man can expect to live to 81.[9] This gap is expected to persist into the future. Because women live longer, they depend on Social Security for more years, and become increasingly dependent on Social Security with age. Unmarried women between 65 and 74 years old get 43 percent of their income from Social Security, while unmarried women 75 and older get 55 percent of their income from Social Security.

EXPECTED TOTAL LIFETIME FOR PERSONS AGE 65		
Year Turning Age 65	**Male**	**Female**
1940	77.0	78.7
1998	81.2	84.8
2030	82.7	86.1

- **Women Have Lower Lifetime Earnings than Men.** Women have lower *lifetime* earnings than men do for three reasons:

  - **Women Who Work Are More Likely to Work Part-time.** In the third quarter of 1998, 25.8 percent of female workers worked part-time, compared with 10.6 percent of male workers. Women represented 67.5% of all part-time workers.[10]

  - **Full-time Female Workers Earn Less than Full-time Male Workers.** The median earnings of full-time year-round women workers in 1997 was $24,973, compared to $33,674 for men -- that means that the median woman earns 74 percent of the median man's earnings.[11]

- Women Take More Years Out of the Labor Force than Men Do. Women are more likely to take time out of the labor force for child raising or other care giving responsibilities. Of workers retiring in 1996, the median woman had worked 27 years over her lifetime, while the median man had worked 39 years.[12]

- **Women Reach Retirement with Smaller Pensions and Other Assets than Men Do.** Only 30 percent of women aged 65 or older were receiving their own pensions in 1994 (either as a retired worker or a survivor), compared with 48 percent of men. Section IV describes issues related to women and pensions in more detail.

How the Current Social Security System Helps Women Meet Retirement Challenges

The current Social Security system has a number of features that are particularly important to women.

- **Social Security Provides an Inflation-Protected Benefit That Lasts as Long as You Live.** Although women receive lower average Social Security benefits than men do, women tend to live longer than men and to receive benefits for more years. In addition, because women live longer, they are in greater danger of outliving their other sources of retirement income; but it is impossible to outlive one's Social Security benefit. Furthermore, the cost of living protection in Social Security is more valuable the longer a person lives; therefore, this feature of the program is particularly valuable to women.

- **The Progressive Benefit Formula Provides a Higher Replacement Rate for Workers with Lower Earnings.** Since women tend to have lower earnings than men, they receive worker benefits that are a higher fraction of their lifetime earnings. For the median female retiree, Social Security replaces 54 percent of average lifetime earnings, compared with 41 percent for the median male.[13]

- **Social Security Provides Extra Benefits to Spouses with Low Lifetime Earnings.** Women are more likely than men to take time out of the labor force for child rearing, and, on average, have lower earnings when they work than men do. This means that the Social Security benefit they are entitled to -- based on their own earnings history -- can be small. But Social Security provides a spousal benefit that helps many women, even if they did not work at all outside the home. A spouse receives a benefit equal to the larger of the benefit she is entitled to based on her own earnings or one-half of the benefit received by her husband. Currently, 63 percent of female Social Security beneficiaries age 65 and over receive benefits based on their husband's earnings record. (Only 1.2 percent of male Social Security beneficiaries receive benefits based on their wife's earnings record). The result is women receive more than they would based only on their own earnings histories. While the average full benefit a women is entitled to based on her own earnings record is only 62 percent of that of men, the average benefit received by women is 75 percent of that of men.[14]

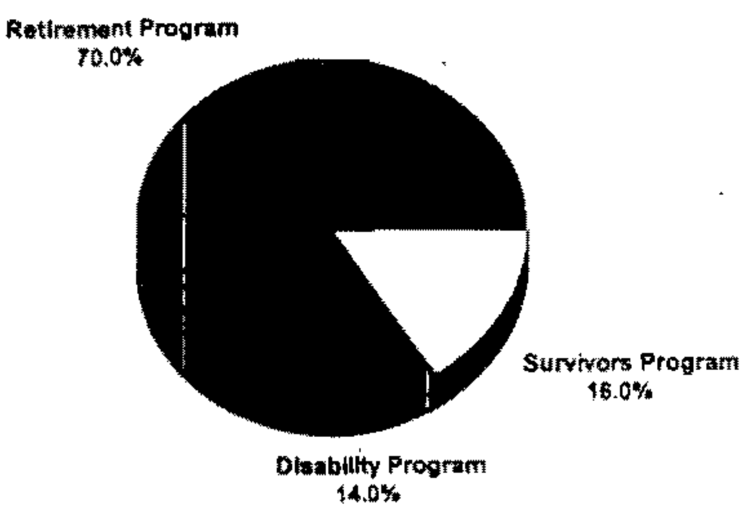
- **Social Security Provides Benefits for Widows.** Social Security pays an elderly widow a benefit equal to either the benefit she receives as a worker or the benefit of her deceased spouse, whichever is higher. Nearly three quarters -- 74 percent -- of elderly widows receive benefits based on the earnings of their deceased spouse.

- **Social Security Provides Benefits to Spouses with Young Children.** Social Security provides benefits to spouses of any age who care for children under 16 if the worker (other spouse) is retired, becomes disabled, or dies; women represent 98 percent of recipients receiving benefits as spouses with a child in their care.

  - **Nearly One-Third of Social Security Beneficiaries Are Either Disabled or Survivors (or Their Dependents).** Nearly one-third of Social Security's 44 million beneficiaries are either disabled or survivors (or their dependents). This includes 3.8 million children who receive benefits, with 1.9 million as survivors of deceased parents, 1.4 million as children of disabled workers, and 0.4 million as children of retired workers. Disability insurance (in case an individual becomes disabled and can't work) and survivors' insurance are each separately equivalent, for the average young family with two children, to an insurance policy of about $300,000.

Social Security Is More Than A Retirement Program

Percentage of Social Security Beneficiaries By Program



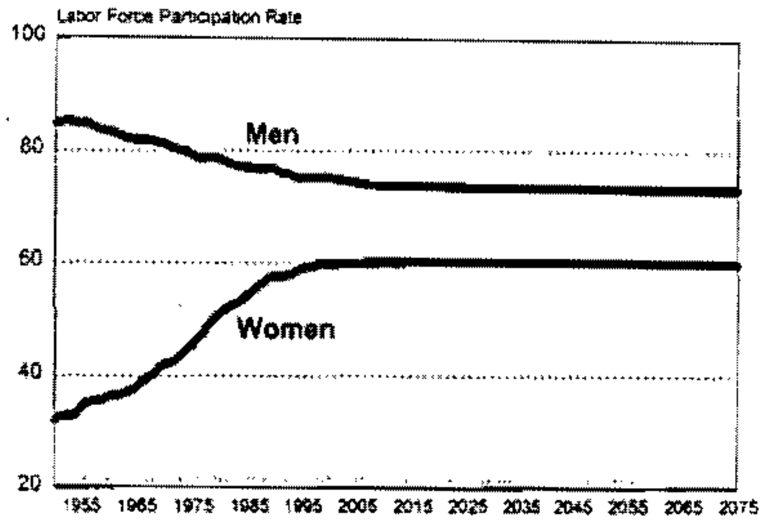
Will Social Security Continue to Be as Important for Women in the Future?

As younger cohorts of women reach retirement, more and more female beneficiaries will receive benefits based upon their own earnings records. Nonetheless, the average benefit received by women is expected to remain below that of men, and a significant share of women will continue to receive benefits based on their spouse's earnings record.

- **Labor Force Participation Rates among Women Have Risen Dramatically.** In the future, women will reach retirement with much more substantial earnings histories than in the past. (Male labor force participation has been falling due largely to earlier retirement).

Labor Force Participation Rates

1950-2075



Source: Social Security Administration. Data are age adjusted

- **More Women Will Receive Benefits Based Solely On Their Own Earnings History.** The percentage of women receiving benefits based solely on their own earnings history is expected to rise from 37 percent today to 60 percent in 2060. However, this means that 40 percent of women will continue to receive benefits based on their husband's earnings.[15]

- **Average Benefits Based On Own Earnings Record Will Rise Relative to Men.** The average full monthly benefit for retired female workers based on their own earnings record, which is currently 62 percent of the average for men, will rise to 67 percent in 2050.[16]

- **Projections Indicate That Women Will Continue to Live Longer than Men.** The difference in life expectancy at age 65 between men and women will fall only slightly under Social Security Administration projections from a gap of 3.6 years today to 3.4 years in 2030. Thus, in the future, women will continue to depend on Social Security for more years than men will.[17]

III. Challenges for the Current System

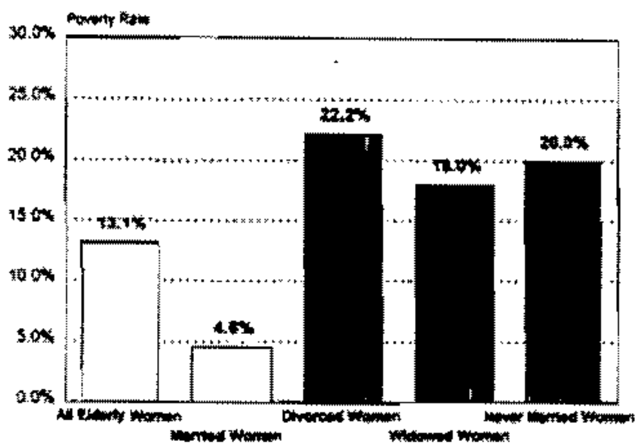
Poverty Rates Remain High Among Elderly Women

- **Poverty Rates Among the Elderly Have Fallen Dramatically, Due Largely to Social Security.** The poverty rate among Americans age 65 and over has fallen from 35.2 percent in 1959 to 15.2 percent in 1979 and 10.5 percent today. This compares with an overall poverty rate of 13.3 percent.

- **Poverty Rates among Widowed, Divorced, and Never Married Women Remain High.** The poverty rate for all elderly women was 13.1 percent in 1997, compared to a 7.0 percent rate for all elderly men. For both divorced and widowed women, poverty rates are significantly higher than men: the poverty rate is 22.2 percent for divorced women and 15.0 percent for divorced men and the poverty rate is 18.0 percent for widowed women and 11.4 percent for widowed men. Married couples had a poverty rate of only 4.6 percent.

Poverty Rates Are High Among Unmarried Elderly Women

1997



Source. Social Security Administration. Based on Data from the Census Bureau.

- **Widows Make Up A Large Fraction of Elderly Women.** Of women 65 and over, 45 percent of women are widowed, 43 percent are married, 7 percent are divorced, and 5 percent are never married. This means that the high poverty rate among widows and other unmarried women affects a large share of elderly women.

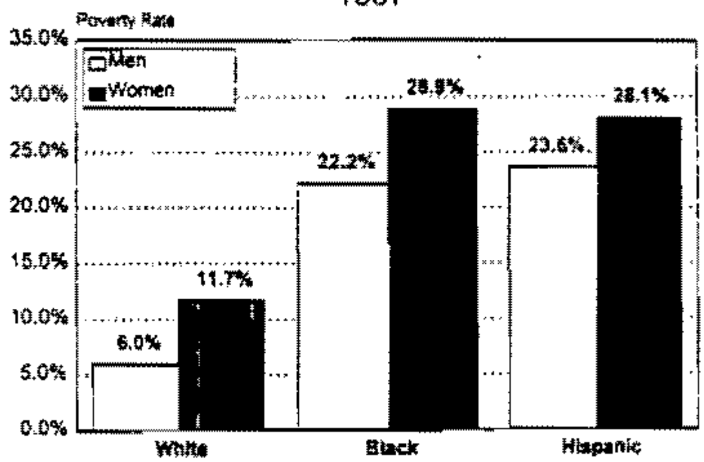
- **There Are Also a Substantial Number of Relatively Young Widows, Though the Number Is Falling.** Of 60-year old women, 13 percent are widows. This percentage rises to more than one-quarter of women aged 65 to 67. Because husbands in low-income families tend to die at younger ages than husbands in higher-income families, these early widows are often poor.

- **Divorced Women Are a Growing Share of the Elderly Population.** In 1997, 7.1 percent of elderly women were divorced -- this compares with only 2.2 percent in 1969. Among women approaching retirement (55-64 years old), 14.4 percent were divorced in 1997. Since divorced women have higher poverty rates than other women, this trend could lead to higher poverty rates for women in the future.

- **Poverty Rates Are Higher among Elderly Blacks and Hispanics.** The poverty rate for black women aged 65 or above is 28.9 percent, compared with 28.1 percent for Hispanic women, and 11.7 percent for white women. The poverty rate for black men aged 65 or above is 22.2 percent, compared with 23.6 percent for Hispanic men, and 6.0 percent for white men.

Poverty Rates Are Particularly High Among Elderly Minority Groups

1997



Source: Bureau of the Census

Reasons Why Poverty Rates Are Higher Among Widows than Among Married Women[18]

- **Declines in Social Security Benefits at Widowhood.** Widow benefits vary from 50 to 67 percent of benefits for a married couple. The official poverty thresholds imply that a widow needs 79 percent of a couple's income to maintain her pre-widowhood consumption level. Thus, women who are in couples just above the poverty line, can fall below the line when they become widowed. Empirical studies suggest that this factor can explain as much as half of the excess in poverty among widows.

- **Pre-Widowhood Differences in Economic Status.** Poorer husbands typically do not live as long as richer husbands. Therefore, at a given age, women who are widowed are more likely to have been poor throughout their lives than are the women whose husbands have not yet died. Empirical studies conclude that this fact explains around one third of the difference in poverty rates between married women and widows.[19]

- **Declines in Pension Income at Widowhood.** Research using data from the 1970s implies that roughly 15 percent of the gap in poverty between widows and married women can be explained by the loss of the husband's pension income. However, these data predate the Retirement Equity Act of 1984 which was designed to encourage the choice of a pension with survivorship rights.

- **Declines in Income from Other Assets at Widowhood.** Some assets may be bequeathed to people other than the widow or used for medical or other expenses when the widow's spouse dies. Empirical evidence suggests that the decline in other asset income is responsible for about 10 percent of the difference in poverty rates between widowed and married women.

Issues Concerning Benefits for Spouses who Work in the Home and Benefits Based on Paid Employment

- **Spousal Benefit Ensures Adequate Retirement Income.** A woman is eligible to receive a Social Security benefit that is 50 percent of her husband's benefit while her husband is alive, and a benefit that is 100 percent of her husband's benefit after he dies. These benefits reward women for work done in the home and ensure that all Americans have an adequate retirement income, even those with little paid employment. However, some people argue that spouse benefits are unfair because women with many years of paid employment can end up with benefits that are no larger than stay-at-home moms, and others point out that two families with identical total earnings can end up with different Social Security benefits depending on the division of the earnings between the two spouses.

Social Security provides a key foundation for retirement security. Pensions and individual savings provide important resources as well. For elderly married couples, these other sources of income account for 64 percent of total income. For elderly unmarried females, these other sources account for 49 percent of total income.

Among Current Retirees, Women Have Much Less Pension Coverage Than Men

- **Women Are Less Likely To Have A Pension.** Only 30 percent of all women aged 65 or older were receiving a pension in 1994 (either worker or survivor benefits), compared to 48 percent of men.[20]

- **Lower Pension Coverage Among Private-Sector Workers.** Only 31 percent of women aged 65 or older (and 55 percent of men) who had worked in the private sector reported pension benefits, compared to 66 percent (and 75 percent of men) of public sector retirees.[21]

- **Pensions Received by Women Are Worth Less than Those Received by Men.** Among new private sector pension annuity recipients in 1993-94, the median annual benefit for women was $4,800, or only half of the median benefit of $9,600 received by men. The median pre-retirement wage replacement rate of annuity benefits was 20 percent for women, compared to 30 percent for men. Among lump sum pension recipients in 1993-94 who were age 40 and over, the median lump sum distribution was $5,000 for women and $14,475 for men.[22]

- **Among Women Approaching Retirement, Pension Wealth Is Much Smaller.** Single women had average pension wealth that was 34 percent of the single men's average. Among married people, the gender gap was even larger, with the women's average being only 25 percent of men's. These estimates include both private and public sector workers with and without pensions.[23]

401(k) Plan Take-up Rates

- **Women Are Less Likely To Take Up 401(k) Option When Offered.** Among private wage and salary workers offered a 401(k) plan in 1993, the overall participation rate was 62 percent for women and 70 percent for men.[24]

- **Lower Take Up Is Largely Explained By Lower Earnings.** The take-up rate is highly correlated with earnings. For example, while only 39 percent of workers earning less than $15,000 per year participate in a 401(k) plan when offered, 90 percent of workers earning $75,000 or more do so. Because men, on average, earn more than women, their overall take-up rates in 401(k) plans are higher. However, when wages are held constant the take-up rate for women is generally equal to or greater than that of men. Among workers earning less than $15,000 in 1993 the take-up rate was 41 percent for women compared to 35 percent for men. For workers earning from $30,000 to $40,000 the take-up rate was 75 percent for women and 72 percent for men.[25]

Among Workers, Women's Pension Coverage Depends on Work Status[26]

- **Overall, Fewer Women Have Pensions Through Work.** For all female workers -- both full time and part time -- 27 million (40 percent) had a pension plan through work in 1997. For all male workers, 34 million (44 percent) had an employment based pension.

- **In Full-time Jobs, Women Are Equally Likely To Have Pension Coverage.** Twenty five years ago, pension coverage for women in full-time jobs was only 70 percent of the rate for men. Today, the coverage rates are nearly identical. In 1997, 50 percent of women in full-time jobs had pension coverage, compared with 49 percent of men.

- **Coverage Is Significantly Lower for Part-time Workers.** Coverage is significantly lower for women who work part time. In 1997, 15 percent of women working part time were covered by pensions versus 50 percent working full time.

- **Women Are More Likely to Work Part-time or Be Out of the Labor Force than Men.** In 1997, 75 percent of men were in the labor force, versus 60 percent of women. In addition, over one fourth of working women were part-time, compared with one tenth of men.

- **Women Who Work Part time Are Less Likely To Work For Firms With Pension Plans.** In 1997, of the 48 million women workers employed full time, 30 million (63 percent) worked for a firm with a plan. Among the 20 million women employed part time in 1997, only 7 million (36 percent) worked for a firm sponsoring a pension plan.

- **Women Who Work Part time Are Less Likely to Participate in Pension Plans.** Among women employed by firms sponsoring pension plans, those employed on a part-time basis are far less likely to participate in the plan, primarily because plans often exclude employees working less than 1,000 hours per year. Of the 30 million full-time women workers in 1997 employed with firms with plans, 24 million (80 percent) participated in the plan. Of the 7 million part-time women workers employed by firms with plans, only 3 million (41 percent) participated in the plan.

- **Vesting Rate is Higher for Women Who Work Full time.** For women participating in a pension plan the vesting rate is higher for those who work full time, particularly for those with less than five years of service. In 1993, 64 percent of women with less than five years of service who were employed full time in private sector jobs reported that they were vested, compared to 56 percent of women employed part time. A total of 325,000 women with less than five-years of pension service in a part-time job reported that they were not vested.[27]

Women Have Smaller Non-Pension Wealth as Well

- **Median Net Worth Is Lower for Women.** In 1993, the median female householder aged 65 or older had $9,560 in financial net worth (not including equity in own home). In comparison, the median male householder had $12,927, and the median married couple had $44,410.[28]

V. CONCLUSION

As discussions of Social Security reform continue, it will be important to study the impacts of comprehensive reform proposals on women. The design of reforms must take into account, not only the current characteristics of elderly women, but also the changes in their needs that are likely to come about in the 21st century as more women with long work histories reach retirement. In addition, reforms should consider the entire range of sources of retirement income available to women and how Social Security can best fit into the overall retirement security package.

ENDNOTES

1. Social Security Administration, Office of Policy, October 1998.

2. Bureau of the Census, *Poverty in the United States: 1997*, September 1998.

3. Social Security Administration, Office of Policy, October 1998.

4. Social Security Administration, Office of Policy, October 1998.

5. Social Security Administration, Office of Policy, October 1998.

6. Social Security Administration, Office of the Chief Actuary. October 1998.

7. Social Security Administration, Office of Policy, October 1998.

8. These calculations make the assumption that other income would not change if Social Security were not available.

9. Social Security Administration, Office of the Chief Actuary.

10. Bureau of Labor Statistics, Current Population Survey, October 1998.

11. Social Security Administration, Office of Policy, October 1998.

12. Social Security Administration, Office of the Chief Actuary, October 1998.

13. Social Security Administration, Office of the Chief Actuary.

14. The average benefit based on women's own earnings is the average for only those women claiming benefits as retired workers. Thus, it does not include the 37.5 percent of aged female beneficiaries who receive benefits as wives or widows only. Including these additional beneficiaries with full "worker" benefits of zero in the average would reduce the average full benefit for women as a share of the average full benefit for men to 39 percent.

15. Social Security Administration, Office of the Actuary.

16. The average benefit for retired female workers based on their own earnings records is calculated using only those women claiming benefits as retired workers. In the future, increased labor market experience will be divided between increased years of work for women who already have been receiving retired worker benefits, and additional women becoming eligible for worker benefits. As more women claim benefits as retired workers, many of the additional women will have earnings below the average for women already claiming as retired workers. This expansion of the population used in calculating the average explains in part why the average is forecast to rise only from 62 to 67 percent of the average for men even as cohorts of women retire with much greater labor market experience.

17. Social Security Administration, Office of the Actuary.

18. The subsequent estimates are based on integrating evidence from a number of studies, including the following: Hurd, Michael D. (1990). "Research on the Elderly: Economic Status, Retirement, and Consumption Savings," *Journal of Economic Literature*, XXVIII(2): 565-637. Holden, Karen (forthcoming). "Insuring Against the Consequences of Widowhood in a Reformed Social Security System," In National Academy of Social Insurance, *Framing the Social Security Debate: Values, Politics, and Economics*, Brookings Institute. Holden, Karen C., Richard V. Burkhauser, and Daniel A. Myers (1986). "Income Transitions at Older Stages of Life: The Dynamics of Poverty," *The Gerontologist*, 26(3): 292-297.

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24. Department of Labor, Current Population Survey, April 1993.

25. Department of Labor, Current Population Survey, April 1993.

26. Unless otherwise noted, data in this section are from the Department of Labor, Current Population Survey, March 1998.

27. Department of Labor, Current Population Survey, April 1993.

28. Bureau of the Census, *Asset Ownership of Households: 1993*, August 1995.

SOCIAL SECURITY AND MINORITIES

- **Social Security is particularly important for minorities.** Social Security is the only source of income for 33 percent of elderly Hispanic Americans, 33 percent of elderly African Americans, and 16 percent of elderly white Americans.

- **Social Security combats poverty among elderly minorities.** Without Social Security benefits, 61 percent of elderly Hispanic Americans and 62 percent of elderly African Americans would be in poverty (compared with 49 percent of elderly white Americans).

- **The survivors insurance program is particularly significant for African Americans because they are more likely to die before the retirement age.** African-Americans make up approximately 12 percent of the American population, but 23 percent of surviving children being paid by Social Security.

- **African American families are more likely to receive benefits from the disability program.** In 1995, 12 percent of the population was African American, however, 18 percent of disabled workers award benefits were African American.

RATES OF RETURN FOR AFRICAN AMERICANS:

- Average incomes for African Americans are lower than for whites. Thus African-Americans receive a higher than average rate of return on Social Security (because the benefit formula is progressive). This is somewhat offset by lower life-expectancies: life expectancy at age 65 is two years less for blacks than for whites.

- **However, a 1993 Treasury study shows that on net, African Americans have a slightly higher rate of return on Social Security than whites.** African Americans also fare relatively better under the DI program than whites.

RATES OF RETURN FOR HISPANICS:

- **Hispanic Americans do better on average than other Americans within Social Security.** Hispanic Americans, on average, have higher life expectancies and lower incomes than other Americans -- both of which boost their rate of return on Social Security.

BACKGROUND ON RETIREMENT INCOME AND PENSIONS

RETIREMENT INCOME:

- The vast majority of Americans depend on Social Security for much of their retirement income.

  -- Social Security benefits represent the majority of income for two-thirds of elderly beneficiaries, and are the *only* source of income for 18 percent of its elderly beneficiaries.

- However, Social Security is only one leg of the "three-legged stool" of retirement income. Private pensions and personal savings are a necessary components of a secure retirement income.

  -- Currently, Social Security replaces just one-half of pre-retirement income for an individual who earned $15,000 a year. It replaces less than one-quarter of the income of an individual who earned $68,000 a year.

  -- Social Security is virtually the only source of income for individuals in the lowest two income quartiles of Americans. Individuals in the highest income quartile rely on other sources of income (pensions, savings, wages) as much as on Social Security income to meet their financial needs in retirement.

SOURCES OF INCOME FOR PERSONS AGES 65 AND OLDER

Source of Income	Percentage of Total Income
Social Security	40.3
Earnings	20.0
Private and government employee pensions	18.0
Income from Assets (including savings)	18.0
Other	3.7

- Less than half of all individual aged 65 and older received a private pension in 1994.

PENSIONS:

- **Despite the large increase in workers covered by defined contribution (DC) plans, half of all American workers are not covered by a pension plan**

  -- The number of defined contribution (DC) plans more than tripled, from 208,000 in 1975 to an estimated 647,000 in 1997, and the number of participants almost quadrupled, from 12 million to 46 million. (The number of workers in defined benefit plans has remained constant, while the number of DB plans have fallen in part because many small businesses have discontinued their plans.)

  -- Nonetheless, half of all American workers, more than 50 million, are not covered by a pension plan.

  -- Only 21 percent of private sector workers earning under $15,000 per year have pension coverage, as opposed to 81 percent of workers earning $50,000 or more per year.

  -- Only 24 percent of full-time workers in firms with fewer than 100 employees have pension coverage, as opposed to 68 percent of full-time workers in firms with 100 or more employees.

INDIVIDUAL ACCOUNTS

FRAMEWORK FOR ANSWERS:

- **The President Has Said That He Will Examine Any Proposal in the Context of a Comprehensive Reform to See if it is Consistent With His Five Principles.** As part of an overall plan, many ideas are on the table. Ultimately, what we must consider is whether a comprehensive reform package meets his principles. That's why we don't want to judge any specific element now.

- **At the Kansas City Forum, the President Said That He Will Consider Whether Some Form of Individual Accounts Can Be Part of a Comprehensive Reform That Meets His Principles.** We especially need to consider whether a Social Security system including Individual Accounts continues to provide a benefit that can be counted on and whether the system continues to be fair and progressive.

- **At This Stage in the Debate, We Want to Stay Open Minded and Give Every Option a Fair Hearing.**

KEY ADDITIONAL POINTS:

- **Higher Returns Come with Higher Risk.** Most people have been discussing ways to get higher returns for the Social Security system. Individual accounts could allow a higher rate of return than Social Security currently offers. And individual accounts could also allow every American more control over their retirement assets and give every American a greater stake in the economy. But we must be straight with the American people and acknowledge that with greater returns comes greater risk.

- **Administrative Costs and Government Involvement in the Stock Market Are Major Issues.** It's clear that if these costs are not kept low, they could take a significant chunk of potential returns. On the other hand, those who point out that trust fund equity investments can be done with lower costs need to recognize that some people have concerns about government involvement in the stock market.

- **Cannot Forget about Transition Costs.** Everyone is going to have to be clear about how benefits for people entitled to benefits under the existing system are going to be paid for.

BACKGROUND:

- **Advantages of Individual Accounts:**

  - *Higher Returns.* Individual accounts could allow a higher rate of return than Social Security currently offers. The "equity premium" -- the difference between the average annual rate of return earned by the S&P 500 and the rate earned by bonds -- has averaged 3.84 percent over the past four decades. Many economists are concerned, though, whether this gap will persist into the future.

  - *Greater Sense of Control.* Individual accounts also could allow a greater sense of control over your retirement income.

- **Disadvantages of Individual Accounts:**

  - *Risk Borne By Individual.* Individual accounts would force individuals to bear more of the risk for their retirement income.

  - *Administrative Costs.* Individual accounts would involve high administrative costs, especially compared to investing the Trust Fund in the stock market or the current Social Security system (administrative costs equal only 0.8% of contributions per year). Administrative costs can have a large impact on retirement income: for example, annual administrative costs of 100 basis points would mean 21% less retirement income for a retiree. <u>Peter Diamond has found that in the United Kingdom total administrative costs in the typical retirement account *reduce* retirement income by more than 24%</u>.

  - *Transition Costs Could Be Significant.* Some forms of individual accounts involve significant transition costs because moving from a pay-as-you-go system to some forms of individual accounts could force one generation to pay twice (once for their parents, and once for their individual accounts), or many generations to share those costs.

BACKGROUND ON INDIVIDUAL ACCOUNTS

KEY ISSUES WITH ADD-ON INDIVIDUAL ACCOUNTS FUNDED BY THE SURPLUS:

KEY ISSUE #1: LONG-RUN BUDGET VIABILITY

- Add-on Individual Accounts cannot be funded out of the surplus forever. For example, $500 per worker can be afforded -- as part of a comprehensive reform -- until between 2012 and 2057 depending on which surplus forecast is used (and assuming that surpluses not spent on Individual Accounts after 2008 are used to pay off debt). During the next decade, an add-on Individual Account with contributions of $500 per worker would require 37 percent of the surplus. Over the next 35 years, the funding of these Individual Accounts would represent 0.7 percent of GDP.

- Two percent of payroll Individual Accounts can be funded between 2011 and 2051 depending on which surplus forecast is used. During the next decade, they require 42 percent of the surplus.

- Because these Individual Accounts are dependent on projected surpluses, they create the following future budget scenarios: (1) the perputual commitment to $500 per worker per year will create future fiscal deficits and put pressure to unduly cut back government programs in the outyears -- which may hurt support for this proposal today; (2) may need to seek trigger or other mechanism to ensure that Individual Account funds do not lead to future budget deficits; and (3) could put pressure to use remaining surplus in early years for debt reduction.

- Individual Accounts could also create a "slippery slope" toward privatization if stock market performance was particularly impressive in the near future.

- Contribution to Individual Account does not have to be $500 per worker per year. Lowering the contribution -- to say, $250 -- would mitigate some of these factors.

Key Issue #2: Preservation of Traditional Social Security Benefit

- Protects the 12.4 percent payroll tax for the traditional Social Security system. This approach to individual accounts has the most potential to attract defenders of the traditional system.
- Because the approach brings additional revenue into the system, it reduces the need for overall benefit cuts -- when both the retirement income from individual accounts and traditional benefit are taken into account -- and will appeal to people who favor pre-funding of Social Security's obligations.
- These Individual Accounts could be described as a tax cut.
- Because the benefits from an Individual Account are uncertain, some will argue that the income from the Individual Account should not be counted -- which would show significant benefit cuts.

Key Issue #3: Risk

- Risks of stock market variation and bad investment choices would fall on individuals on the portion of benefits coming from Individual Accounts. Additional "appearance risk" results when people expect the final account value will match its highest level over its lifetime.
- However, the risk in Individual Accounts depends to a certain extent on how they are designed. For example, a "safe investment option" could be provided through inflation-protected Treasury bonds. A minimum benefit or other guarantee could minimize the downside risk of the overall system.
- One possible goal for reform would be to try to design a package in which the traditional benefit plus the individual account totaled as much as current law benefits, if the individual invested in the safe investment option. This would be the default option; those workers who wanted to take on more risk to seek a higher return would be allowed to do so.

KEY ISSUE #4: PROGESSIVITY

- Flat contributions lead to higher benefit levels (as a fraction of current law benefits) for lower-income workers. On the other hand, percent of payroll individual accounts plans do the most for high-income workers.

	Social Security benefit plus annuity from $500/worker individual account (as percentage of current law benefit)	Social Security benefit plus annuity from 2 percent individual account (as percentage of current law benefit)
Low Earner	116.1	101.5
Average Earner	104.0	106.9
High Earner	99.4	111.5

KEY ISSUES WITH CARVE-OUT INDIVIDUAL ACCOUNTS:

KEY ISSUE #1: THE TRANSITION PROBLEM

- When two percent is carved out for Individual Accounts, that revenue can no longer pay for benefits for current retirees. This approach would take $700-$900 billion from the traditional Social Security system over the next 10 years.

- This dilemma -- the "transition problem" -- in moving from a pay-as-you-go system to a funded system is that if the contributions of current workers go into Individual Accounts for their retirements, how do we pay for the retirement of current retirees?

- The unified budget surplus could be transferred to the trust fund and used to pay for benefits under the traditional Social Security system during the transition period. Under the most optimistic long-run budget projections, transfering the *entire* surplus to the trust fund would cover the entire 2.19 percent shortfall <u>plus</u> half of the lost revenue from the carve-out.

- In 40 years, when workers will have contributed to Individual Accounts for their entire working lives, traditional Social Security benefits can be reduced and still leave total retirement income above current law benefits.

- In the short run, though, benefits need to be cut to make up for the lost revenue and for 2.19 actuarial imbalance, but the Individual Account will not be large enough to offset these cuts.

- An important challenge in designing reform plans is to time the benefit cuts and the build up of Individual Accounts so that the total benefits of retirees over the transition do not fall too much.

KEY ISSUE #2: POLITICAL VIABILITY

- A number of the reform plans proposed by moderate Members of Congress take the approach of carve-out Individual Accounts.

- Can be described as a promising new social compact: workers get a payroll tax cut so long as they save it in their Individual Accounts.

- Can use surplus to partially mitigate transition costs.

KEY ISSUE #3: LONG-TERM STRUCTURE OF PROGRAM

- For the average retiree in 2030, the income from an add-on Individual Accounts would account for 18 percent of their retirement income. For a similar retiree, a carve-out Individual Account would be 24 percent of their retirement income. These numbers are even greater for beneficiaries eligible for Social Security in 2050: the add-on Individual Account would be 29 percent and the carve-out would be 38 percent.
- Individual Accounts could be accompanied by a guaranteed benefit or a guaranteed return which would both reduce individual risk (but at a price).

INVESTING TRUST FUND IN EQUITIES

FRAMEWORK FOR ANSWERS:

- **We Know That Finding A Way To Raise The Rate of Return of Social Security Is A Key Issue And Investing the Trust Fund in Equities Is One Proposal Advanced By Many Experts.**

- **Those Who Favor this Option Say That it Is a Good Way to Get Higher Returns with Low Administrative Costs.** Proponents argue that by investing the trust fund in equities, Social Security could receive the high stock market rate of return without the administrative expense of setting up millions of individual accounts. In addition, investment risk would be pooled across *all* Americans.

- **Others Are Concerned about the Government Owning Stock in Private Companies.** Opponents argue that at best this could lead to difficult corporate governance issues (such as how stock proxies would be voted), and at worst, could lead to dangerous political interference because of the temptation for the government to invest in certain industries, certain states, or not to invest in politically unpopular companies.

KEY ADDITIONAL FACTS:

- **Experts Are Split on Investing in Equities.** Experts such as Henry Aaron, Robert Ball, and Robert Reischauer have advocated this approach. Alan Greenspan is opposed to this approach, saying in Congressional testimony that he found it "very dangerous" and that it would have "very far-reaching potential dangers for the free American economy and a free American society."

- **Administrative Costs Are an Important Issue for Social Security Reform.** The current Social Security system has low administrative costs, only 0.8 percent of benefits paid. There would likely be additional administrative costs in a system that invested the trust fund, but not nearly as much as in a system of individual accounts. However, some argue that an inexpensive individual account system is possible -- modeled after the Federal Thrift Savings Plan (TSP) -- providing lower administrative costs with fewer attractive services.

- **Even Ownership of a Small Fraction of the Market by the Trust Fund, Could Raise Issues of the Government Owning Large Fractions of Individual Corporations.** This approach could potentially lead to the government as the "single largest shareholder in 200 of the 500 largest American companies."

BACKGROUND ON RISK

KEY POINT #1: THE CASE FOR EQUITIES

- Stocks have out-performed bonds over nearly all long periods of time in the US during the past century.
  - -- The "equity premium" is the difference between the average annual rate of return earned by stocks and the rate earned by bonds. The table below shows this difference in returns between the S&P 500 and the bonds held by the Social Security trust fund for various time periods.
- During the 20th century in the US, even large stock market declines have been more than made up for in subsequent rebounds.
  - -- A portfolio of a worker who lived through the 1929 crash -- when the S&P 500 lost 85 percent of its value between September 1929 and June 1932 -- would have fully recovered by the end of 1936.

Equity Premium
S&P 500 over Social Security Trust Fund Bonds
(percent per year)

		End Year					
		1949	1959	1969	1979	1989	1996
Start Year	1939	6.91	11.63	9.16	6.69	6.65	6.51
	1949		16.56	10.30	6.61	6.58	6.42
	1959			4.37	1.96	3.45	3.84
	1969				-0.39	3.00	3.64
	1979					6.50	6.09
	1989						5.52

KEY POINT #2: CAUTIONS ABOUT EQUITIES

- **Markets fall.** While 20th century US markets have always rebounded strongly from large market declines, this need not be the case in the future.
  - On three occasions during the past 70 years, the S&P 500 index has declined over two years by more than 35 percent (in nominal terms).
  - Japan's Nikkei index has fallen by 60 percent since 1989.
  - The S&P 500 (even including reinvested dividends) did not regain its 1968 value in real terms until 1983.

- **Perceptions may be colored by recent stock market history.** The tremendous recent stock market performance has likely increased support for investing Social Security funds in equities. If the stock market were performing badly, as it did in the 1970s, it is unlikely that people would be as eager to invest Social Security funds in the market. Indeed, in 1979, *Business Week* ran a cover story entitled "The Death of Equities."

- **Stocks may not retain their historic advantage relative to bonds.** Simple economic models have trouble explaining why the 20th century rate of return on stocks has been so much higher than the return on bonds. Many economists think that the added risk from stocks is not sufficient to justify such a large "equity premium." Given that it is not well understood why stocks have out-performed bonds in the past, some economists are concerned about whether this gap will persist into the future.

- **Shorter market exposure at beginning of new system.** In the transition to a new individual account system, older workers would participate in the system for only a few years before they reached retirement. These workers would not have a full 40 years of market exposure. If a downturn occurred during their few years of contributions, the older workers could end up doing worse than in safer investments.

- **Lack of individual or political patience after downturn.** In a system of Individual Accounts, individuals might shift out of equities after a market decline, missing the recovery. If the trust fund were invested in equities, there might not be sufficient political patience to stay with an equity-based system after a large market downturn. If equity investments were abandoned after the first large downturn, such a system could provide the worst of both systems, the low returns of bonds plus the risk of equities.

- **Perceptions of pre-retirement market declines.** Individuals might feel that they had fared poorly even if they had done better over their lifetime being invested in equities than in government bonds. For example, if the market fell substantially just before a worker retired and annuitized his/her account, he/she might feel that it was unfair that workers who had retired one year earlier received higher retirement incomes. Similarly, if a worker annuitized his/her account balance at a point when the stock market is below a previous peak, the worker might feel like he/she lost even though he/she did better over his/her lifetime.

- **Naïve investor risk.** Some individuals might lack the investment know-how to make wise investment decisions. This risk could be largely eliminated by constraining the investment options available to individuals.

Key Point #3: Risk Under Different Reform Proposals

- **Risk in the current Social Security system.** The current system does not have market risk. However, it has other forms of risk:

  -- Political risk that tax or benefit rules will change. For example, Social Security taxes and benefits have changed numerous times in the past 60 years.

  -- Demographic risk that forecasts of mortality and fertility trends will turn out to be incorrect. For example, if projected fertility rates dropped by 0.3 children per woman, the actuarial imbalance would worsen by about 0.4 percent of payroll.

  -- Economic risk that productivity growth will be higher or lower than currently forecast. For example, if productivity growth fell by 0.5 percentage points, the actuarial imbalance would worsen by about 0.55 percent of payroll.

- **In reforms, only a portion of benefits would be exposed to market risk.** Even in 2070, payroll tax revenue will be sufficient to provide two-thirds of current-law Social Security benefits. If the full payroll tax continues to be dedicated to providing the traditional benefit, then at most one-third of the total Social Security benefit would be at risk.

  -- If only a limited portion of the trust fund -- for example, 25 percent -- were invested in equities, less than 15 percent of benefits would be dependent on stock market performance.

  -- Individual accounts funded with contributions equal to $500 per capita or 2 percent of payroll would typically provide less than 37 percent of total Social Security benefits including IA account proceeds (assuming the accounts were invested half in bonds and half in stocks). Thus, over 60 percent of benefits would be free of market risk.

- **By investing through the Social Security trust fund, some risks are reduced.** With the trust fund partially invested in equities, there would be no need to tie annual benefits to year to year trust fund performance. Thus, market risk could be spread both across workers and across generations. In addition, since individual workers would not be making investment decisions, there would be no "naïve investor" risk.

Key Point #4: Variation In Retirement Income from Market Exposure

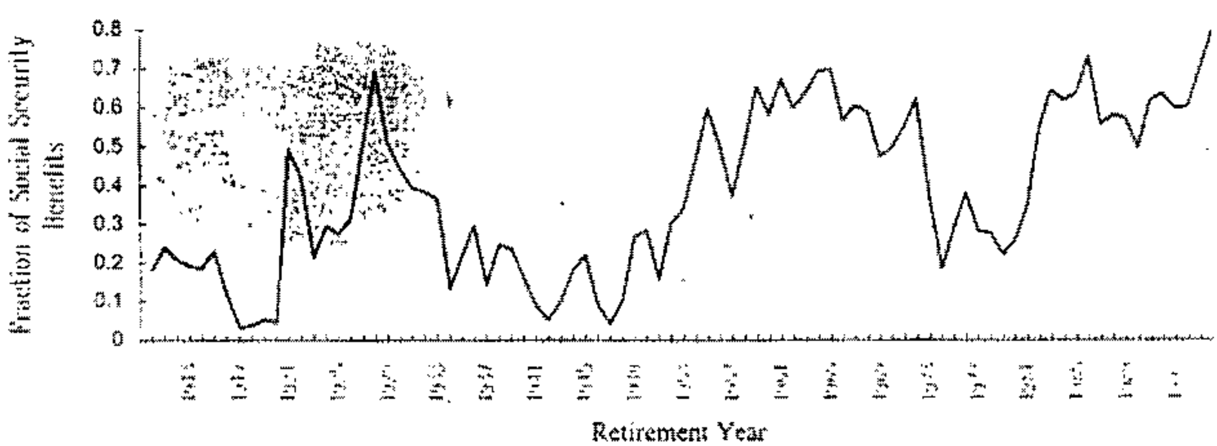
- **<u>Outcomes from market investments depend on when individual retires</u>.** Studies suggest that individuals would have widely different outcomes from market investments solely because of the market performance in the particular years in which they lived. For example, average workers retiring in 1972 would have received a retirement annuity equal to more than 60 percent of their current-law Social Security benefits. However, individuals retiring two years later, in 1974, would have received an annuity that was only 20 percent of their current law benefits.

- **<u>In past century, Individual Accounts could have provided between 5 and 80 percent of an average worker's current law Social Security benefits</u>.** If average workers had had a 2 percent Individual Account and retired a different times in the past century, their retirement annuities would have varied greatly: from 5 percent to 80 percent of their current law Social Security benefits.

- **<u>In most years, Individual Accounts could have provided a large enough annuity to ensure that current benefits were maintained</u>.** One constructive way to view this result is that under the illustrative plans we discussed last week, the traditional Social Security program would continue to provide an additional 66 to 85 percent of current-law benefits (depending on whether the Individual Accounts were implemented as carve-outs or add-ons). Thus, to maintain current benefits, the annuity from the Individual Account would have to be at least 15 to 34 percent of current benefits, depending on whether it were an add-on or carve-out Individual Account.

- **<u>There are a number of limitations to this analysis.</u>** The chart assumes that the entire individual account was invested in the S&P 500, and was annuitized at the Aaa corporate bond rate in the year that the worker turned 65. If a portion of the accounts were invested in bonds, or if annuitization happened in stages, the variation in experiences would be reduced.

Fraction of Social Security benefits replaced by 2% Individual Accounts



KEY POINT #5: WEALTH CREATION

Supporters of Individual Accounts make strong arguments about how such accounts help to create wealth and give lower-income workers a stake in the economy. Advocates base their argument on four ideas:

1. **Access to Higher Rates of Return.** Because nearly half of all Americans have little or no financial assets, Individual Accounts would give lower-income workers access to the higher rates of return offered by the stock market, and allow them to build wealth for their retirement.

2. **Allows Individuals To Use Income However They Want.** Many Individual Account proposals would require retirees who have accumulated a large nest-egg to annuitize enough of the account to provide a basic retirement income, while allowing the retiree to take the remaining money in a lump-sum to be spent as they wish. In other words, retirees would have to set aside a minimum amount of money, but the rest could be used for whatever they desire.

3. **Individual Accounts Could Be Bequeathable.** Some people die before they reach age 65, and Individual Accounts could be bequeathable, thus making it possible for individuals who do not pass along any wealth to their heirs to do so. However, if a portion of individual accounts were bequeathable, the income available for consumption during retirement years would be reduced.

    -- Most reform proposal retain the existing structure for survivor benefits for young people. However, cuts to the Social Security benefit formula -- as part of comprehensive reform -- would reduce survivor benefits.

    -- Permitting bequests is particularly appealing to low-income and minority populations which have lower life-expectancy, and therefore, on average, would not receive their Individual Account annuity for as many years. For example, life expectancy at age 65 is 1.8 years shorter for blacks than for whites. (In the traditional Social Security system, the progressivity of benefit formulas offsets the shorter life expectancy.)

4. **May Change Perception of Saving.** The experience of owning an Individual Account may lead people who do not save currently to begin saving on their own. By directly showing people the power of compound interest and the benefits of savings, we may alter people's spending habits.

KEY POINT #6: TRANSITION COSTS AND MISLEADING RATES OF RETURN ARGUMENTS

THE CHARGE:

- **Some claim they could do better investing on their own.** Many critics of Social Security point to the rate of return that workers will earn in the future on their contributions into the system, and argue that they could do better on their own investing in individual accounts.

  -- According to the Social Security actuaries, a single male with average earnings retiring in 2030 will receive a real return of only about 1-1/2 percent per year.

  -- By contrast, over the period 1926-1996, stocks earned a real rate of return equal to about 7 percent per year.

- By using the surplus to prefund retirement benefits and invest in equities, it is possible to increase rates of return in the future.

THE TRANSITION ISSUE:

- The story is different if we are talking about funding individual accounts with revenue currently allocated to paying benefits under the current system. In this case, simply calculating rates of return for the individual accounts ignores the need to provide benefits for current and future retirees who have paid into the current Social Security system.

- Ninety percent of contributions into the Social Security system are used immediately to pay benefits to today's retirees and other beneficiaries. If current workers put their payroll tax contributions into individual accounts for their own retirement, we will need to come up with some other way to pay retirement benefits for people who are entitled to Social Security benefits.

- Rates of return that ignore this cost are misleading when compared to Social Security rates of return that include this cost.

IS THE RATE OF RETURN THE CORRECT WAY TO JUDGE SOCIAL SECURITY?

- Some suggest that focusing too much on rate of return does not acknowledge that Social Security plays a distinct role as a universal low risk leg in the retirement structure that you can always count on.

REAL RATE OF RETURN TO SOCIAL SECURITY CONTRIBUTIONS (Percent per year)						
Year born/ year age 65	**Single male earner**			**One-earner couple**		
	Low earnings	Avg. earnings	High earnings	Low earnings	Avg. earnings	High earnings
1920/1985	4.4	2.8	2.5	8.1	6.6	6.3
1930/1995	3.1	1.9	1.5	6.1	5.0	4.7
1964/2029	2.4	1.3	0.7	4.7	3.7	3.1
2004/2069	1.5	0.8	0.2	4.0	3.0	2.4

KEY POINT #8: OPTIONAL INVESTMENTS IN INDIVIDUAL ACCOUNTS

Some reform proposals include a voluntary individual account option. These options are of two types:

TYPE I: Individual Account proposals that allow additional contributions

TYPE II: Non-Individual account proposals that would allow for a Voluntary individual account

ISSUES:

- A main benefit of these proposals is that for the half of all American workers who do not have pension plans this could be a major step toward increasing employment-related retirement savings.

- Some employers who currently resist the administrative burden of setting up retirement programs might match employee contributions, thereby augmenting the impact of the worker's savings.

- However, it is possible that some employers who currently provide a pension to their employees might cancel these plans knowing that their employees have this new retirement savings option.

- In addition, since most employees currently have the option of contributing to an IRA, the new accounts might not be seen as providing much additional impetus for saving.

- Indeed, the plans could be criticized for giving upper-income Americans another opportunity for tax-preferred saving. This risk could be minimized by providing a cap on total contributions to IRAs, 401ks, and the new Individual Accounts.

ADMINISTRATIVE COSTS

KEY POINT #1: INTERNATIONAL EVIDENCE ON ADMINISTRATIVE COSTS IN INDIVIDUAL ACCOUNT PLANS

- **Administrative costs in Chile have been high.** The accumulation of administrative costs over a worker's career results in retirement income in the Chilean system that is 20 percent lower than it would be if there were no administrative costs.

- **In Chile, fund management companies appear to compete on factors other than price.** The funds are highly regulated in the types of allowable investments, and offer very similar portfolios. Individuals are allowed to switch portfolios every 4 months. This has caused fierce competition. The funds spend huge amounts on advertising, have increased their sales forces, and offer incentives such as televisions or trips to lure individuals to their particular fund. This non-price competition has driven up costs.

  -- In Chile there are 3.5 salespeople per 1,000 contributors. In the United States, there are 0.5 SSA employees per 1,000 insured workers.

- **Costs in the early years of the UK individual account system have been high as well.** In the UK, workers can opt out of the earnings-related defined benefit system, and instead contribute to an individual retirement account. A recent paper by Professor Peter Diamond reports that the charges for these individual accounts are large, complicated, and often not visible to the workers. He calculates that the total administrative costs in the typical UK account reduce retirement income by more than 24 percent.

- **The international evidence suggests that it is important to focus on ways to keep costs down.** The lesson from these two examples is not that individual account systems are necessarily expensive, but rather that it is important to design systems in a way that provides the desired services at a reasonable cost.

KEY POINT #2: ADMINISTRATIVE COSTS DEPEND ON SERVICES PROVIDED

- **Administrative costs can have a large impact on retirement income.**

Annual Administrative Costs (basis points per year)	Percentage Reduction in Value of Individual's Retirement Income
10	2.4
50	11.5
100	21.5

- **Current US system has very low costs.** The current Social Security system has maintained an extremely low level of administrative costs. Less than 1 cent of every dollar paid into the system by workers and employers goes to administrative costs. To achieve this low an administrative cost, an individual account plan would have to have annual administrative costs of less than 5 basis points.

- **Investing trust fund in equities would be extremely inexpensive.** Estimates suggest that costs could be only one-half of one basis point.

- **Under individual accounts, costs could vary widely depending on the services provided and on the way in which the accounts are administered.**

Estimated Administrative and
Investment-Management Costs for Individual Accounts
(bps = basis points)

Administering Body	Passive Mutual Fund	Active Mutual Fund
Government-Based (e.g., TSP)	8-16 bps	58-66 bps
Employer-Based (2,000 workers)	36-44 bps	109-117 bps
Employer-Based (25 workers)	76-86 bps	138-148 bps
Individual-Based (e.g., IRA)	81-91 bps	143-153 bps

- **Costs in the early years would be even higher.** Account balances would be small at the beginning, driving up cost ratios.

- **The costs of actively managed funds are significantly higher than are the costs of index funds.** A 1998 Department of Labor study found average expense ratios for actively managed retail large equity funds of 147 basis points, while average expense ratios for index funds were only 59 basis points.

- **Technological advances might reduce the costs substantially in the future.** If fund allocations could be handled by an automatic telephone procedure or over the Internet, individuals could be permitted to reallocate their portfolios frequently at a relatively low cost.

Key Point #3: The TSP Model

- **The Federal Thrift Savings Plan has been a model for many individual account proposals.** Its costs are low -- roughly 10 basis points per year, excluding employer costs of reporting individual earnings to the TSP.

  -- Costs are low in part because TSP offers only 3 investment options -- a stock index fund, a corporate bond fund, and a Treasury security fund -- and all three funds are passively managed. In addition, the participating "employers" (Federal departments and agencies) are large. Finally, the total pool of funds is large, and TSP runs a competitive process in issuing contracts to private fund managers to run the funds.

- **A national government-run system would face much larger challenges.** The TSP covers 2.6 million participants, all of whom work for one employer (the Federal government). A universal personal account system would eventually involve 180 million individual participants, who work for 6.5 million different employers.

  -- Last year over 55 million individuals called the SSA's 800 number. Many additional calls would need to be handled if individual accounts were set up. In recent testimony, Frank Cavanaugh, former Executive Director of the TSP, estimated that a Social Security reform plan modeled after the TSP "would require at least 10,000 highly trained Federal employees to man the telephone and answer employee questions."

- **Corporate governance issues could arise in a TSP-style plan.** Because the government would be contracting with a small number of private-sector managers to invest the aggregate holdings of the accounts, corporate governance issues could arise that are similar to those that would arise if Social Security were invested in equities.

KEY POINT #4: HOW WOULD SERVICES BE PERCEIVED?

- **How would services be perceived?** In a very inexpensive system, the services provided would likely be perceived as inferior to those provided under workers' other investment accounts such as 401ks and IRAs. For example, workers might have their contributions deposited into their accounts only infrequently, be given limited opportunity to reallocate their portfolios, and receive less frequent statements of account balances.

  -- Some analysts fear that people would be disappointed when they realize that under some forms of a TSP approach, deposits would not be made to individual accounts until October of the following year (the date at which SSA and IRS essentially finish reconciling the previous year's earnings). In 401k plans, contributions are made much more frequently.

  -- Others feel that the individual account will seem like a new tax cut and that people will be pleased to receive it. If a new policy is announced that every year $500 or 2 percent of earnings will be deposited into your account 90 days after you file your taxes, it will seem like a good deal.

- **Keeping costs low conflicts with features that give individual accounts their popularity.** Proponents of individual accounts hold up savings account booklets and suggest that people could have frequent reports on account balances, wide investment choices, and the ability to reallocate their portfolios whenever they want. These features would raise costs.

- **Political pressure for added services could drive up costs.** There might be political pressure to introduce additional services, such as emergency loans against the accounts. The additional services would drive up costs.

CORPORATE GOVERNANCE

KEY POINT #1: POTENTIAL PROBLEMS

- Some experts have proposed that as much as 50 percent of the Social Security trust fund be invested in equities. Under this scenario, the trust fund would be a very large share of the U.S. stock market. In fact, it could rise to as high as 15-30 percent of total equity holdings in 2030.

- Even smaller fractions could raise issues such as "the government is the largest single shareholder of 200 of the 500 largest companies."

- Additional possible implications of investing the trust fund in equities include:

  1. Political pressure on investment decisions. Political considerations could influence the manner in which the Trust Fund is invested.

  2. Corporate governance issues. The government will have to decide whether and how to exercise its right as a shareholder to choose corporations' managers and influence business decisions.

  3. Constraints on economic policy-making. Investing a large share of the Trust Fund in equities could constrain economic policies that affect stock prices.

  4. Similar issues are present with individual accounts. Some of the issues listed here could also arise under a system of individual accounts if the system were centrally administered and investors were limited to a small number of investment vehicles.

KEY POINT #2: POTENTIAL SOLUTIONS

A number of strategies have been suggested for limiting the risk of these adverse outcomes. Several of these strategies are interrelated.

- *An independent investment board.* Like the members of the Federal Reserve Board, the members of a Social Security Investment Board could be appointed to long overlapping terms, and could be subject to removal only "for cause." The Board could be empowered to determine its own budget and submit it directly to the Congress.

- *Qualifications.* Members of the board could be required to be from the private sector, and have substantial expertise in the investment industry, pension industry, or similar background. (Such qualifications are currently required of the TSP Board members.) Nominees could be rated as "well qualified," "qualified," or "not qualified" by some outside group in a procedure modeled on the rating of judicial candidates by the ABA.

- *Strict fiduciary duty.* The Board could be charged with acting in the sole interests of the beneficiaries of the Trust Fund, and no other interests, however meritorious.

- *Limited investment choices.* The experience of the state pension funds suggests that scope for non-economic investing is especially great when the available range of investment vehicles is broad. For example, some state funds are authorized to invest in local infrastructure, in-state equity funds, Ginnie Mae and Fannie Mae pools, residential mortgages, and small-business loans. By contrast, the Thrift Investment Board is authorized to invest in only five broad funds, and thus far has avoided any difficulty with issues related to corporate governance.

- *Proxy voting strategies.* Some have suggested that government-owned shares simply not be voted, or be voted in proportion to the votes of non-governmental shareholders. This approach would have the downside of effectively destroying one of the important sources of value in share ownership, namely the power to vote, and facilitating the ability of managers to be unresponsive to shareholders. In addition, minority shareholders could be turned into majority shareholders. One alternative strategy for dealing with this issue would be to require that the shares be voted by the private-sector firms serving as portfolio managers; these firms would be under fiduciary responsibility to act in the best interests of the beneficiaries of the plan. Another options would be to limit the share of any one company that the government could hold.

- *Culture of non-interference.* Since Congress could pass a law altering any of the safeguards, it will be important that a culture of non-interference develop around the independent board, similar to the culture surrounding the Fed.

Key Point #3: The New Canadian System

The Canada Pension Plan (CPP) is expected to begin investing in private securities in early 1999. Draft investment regulations have been proposed, and final regulations are expected to be issued later this summer.

- Investment decisions will be taken by a 12-member Investment Board (yet to be named). Each member of the Investment Board will serve a three-year term, can be reappointed, and will receive pay similar to that in the private sector.

- The members of the Investment Board will have a fiduciary responsibility to the fund; specifically, the Board members are to "manage any amounts transferred to it . . . in the best interests of the contributors and beneficiaries" of the CPP. They will be held to a "prudent person" standard, and members with special knowledge or skill will have a higher level of responsibility.

- By law, the fund will be prohibited from investing more than 20 percent of CPP funds in foreign markets (equities and bonds). However, there has been much speculation that this limit will be raised or eliminated.

- The draft regulations covering the first three years of operation call for all investment in equities to be undertaken passively (that is, via one or more indexes).

- The Investment Board will be prohibited from investing more than 10 percent of the fund in any individual company, and from owning more than 30 percent of the voting shares of any one firm. Some real estate holding would be permitted.

- After three years, the investment regulations will be reviewed by the Finance Minister and the provinces.

RAISING THE RETIREMENT AGE

FRAMEWORK FOR ANSWERS:

- **This Is Clearly a Major Issue That Needs to Be Discussed During this Year's Debate. Increased Life Expectancy Combined With Early Retirement Are Primary Causes of The Social Security Problem -- Here and Around The World.**

    - *Life Expectancy Is Rising.* Not only is our senior population doubling in the next 30 years, but life expectancy among seniors is increasing dramatically. Sixty years ago, life expectancy for those at age 65 was about 77 for men and 79 for women. Today, it is 81 for men and 85 for women. And rising for both.

    - *More Americans are retiring earlier.* In 1962, only 18 percent of Americans chose to receive their Social Security benefits at age 62. By 1996, that percentage had more than tripled, to 60 percent. The reasons for the increase in early retirement are diverse -- but it is occurring across the world. In nearly every other industrialized country (especially Italy, Japan, Germany), the share of the population that is over 65 is rising even faster than in the US and retirement systems are being strained.

- **However, In Examining Any Proposal To Improve Social Security Solvency -- Including This One -- We Must Balance The Goal of Solvency With The Goal of Fairness. Thus, We Must Look Closely At This Proposal's Impact on Americans Who Have Physically Demanding Jobs.**

    - *Some Workers Can't Work Late Into Their 60s.* For manufacturing workers who have worked with their hands and kindergarten teachers who have stood on their feet, working late into their 60's may not be a real possibility. Therefore, we must balance the goals of solvency with fairness.

    - *Between 20 and 25 Percent of Workers Feel They Must Retire Early.* Today, 12 percent of the near elderly are already receiving disability benefits. And another 20-25 percent of those about to retire feel that they must retire because of health reasons or the fact that they no longer can do their physically demanding jobs.

- **As Part of This Social Security Dialogue, We Need To Come Up With The Best Possible Thinking To Balance The Solvency Concerns of Longer Lifespans With Fairness Concerns With People Working In Different Types of Jobs. Because This Issue Is So Important, I Hope We Will Discuss it at the White House Conference on Social Security This December.**

BACKGROUND ON THE RETIREMENT AGE

CURRENT LAW:

- **The Normal Retirement Age Is Currently 65.** But people can retire as early as 62, with reduced benefits.

- **1983 Reforms Gradually Raise the Normal Retirement Age to 66 for Workers Who Reach Age 62 in 2005.** Then the retirement age will remain at 66 until 2016, when it will begin increasing gradually again until it reaches 67 in 2022. The earliest eligibility age will remain 62.

    - The normal retirement age for someone who is 54 years old today is 66.

    - The normal retirement age for someone who is 37 years old today is 67.

REFORM PROPOSALS WOULD:

1. Phase in the retirement age increase from 66 to 67 more rapidly than is currently scheduled,

2. Raise the retirement age beyond 67, or

3. Index the retirement age to life expectancies.

BACKGROUND ON RETIREMENT TRENDS

AMERICANS ARE LIVING LONGER THAN IN THE PAST:

The challenges of financing the retirement of the baby boomers and of future generations of retirees are largely the result of good news -- people are living longer.

LIFE EXPECTANCY AT AGE 65			
Year turning age 65	Male	Female	Total
1940	12.0	13.7	12.9
1998	16.2	19.8	18.1
2030	17.7	21.1	19.4

- Increased longevity and reduced fertility imply a falling ratio of workers to beneficiaries. The ratio of workers to beneficiaries was 5.1 in 1960 and is 3.4 today. It is expected to fall below 2 in 2035 and reach 1.8 by 2075.

- Similar trends are occurring around the world. As the chart below shows, many countries are aging much more rapidly than the U.S.

RATIO OF PEOPLE AGE 65 AND OLDER TO PEOPLE AGES 20 TO 64 (In percent)			
	1990	2010	2050
Japan	19.3	35.8	60.1
Germany	23.6	32.9	57.5
France	23.4	27.2	48.4
Italy	24.3	33.8	66.7
United Kingdom	26.7	28.6	45.8
Canada	18.6	22.9	46.5
United States	20.8	21.3	37.0

AMERICANS ARE RETIRING EARLIER THAN IN THE PAST:

- In 1950, nearly half (46 percent) of men 65 and older were in the labor force. Today only 16 percent of men 65 and older are in the labor force. In 1950, 10 percent of women 65 and over were in the labor force, while 8 percent participate today.

- Over the past 3 decades, the percentage of Americans who receive Social Security retirement benefits before age 65 has increased dramatically.

PERCENTAGE OF FIRST RECEIPT OF RETIREMENT BENEFITS BY AGE				
Year/Age	62	63-64	65+	TOTAL
1962	18	19	63	100
1970	27.8	23.2	49.0	100
1980	40.5	22.2	37.3	100
1990	56.6	20.2	23.2	100
1996	60.1	18.3	21.6	100

EXPLANATIONS FOR WHY PEOPLE ARE RETIRING EARLIER THAN IN THE PAST:

- Social Security has made it possible for more elderly to afford to retire. In particular, the introduction of the early retirement age in 1961 (1956 for women) has enabled people to retire before age 65.

- Rising incomes have made it possible for some people to afford to retire even before they are eligible for Social Security.

- Private pension plans can create incentives to retire early.

- Society's attitude toward the appropriate age of retirement may have changed.

THE HEALTH OF THE ELDERLY IS IMPROVING, BUT SOME PEOPLE WORK IN PHYSICALLY DEMANDING JOBS:

- In a recent survey, one-quarter of retirees said that poor health was the most important reason why they retired.

- The percentage of workers approaching retirement who work in physically demanding jobs has been declining and is expected to decline further in coming decades. However, there remains a segment of the population, particularly the lower paid and African Americans, who tend to work in these physically demanding jobs.

- Estimates of the percentage of workers approaching retirement who are in physically demanding jobs range from 11 percent to over 30 percent depending on the definition used.

- A recent academic study concluded job flexibility -- particularly the ability to shift to part time work -- has a large impact.

BACKGROUND ON HEALTH AND DISABILITY AMONG ELDERLY

KEY FACTS:

- **Reduced mortality from heart disease and stroke is responsible for most of the increase in life expectancy for older Americans since 1940.** As recently as the early 1970s, there were few effective treatments for severe cases of these illnesses; prevention was the main cause of reduced mortality. Over the past 25 years, the treatment of heart attacks and other severe forms of heart disease has improved. Sophisticated procedures like angioplasty and bypass surgery have become commonplace, and many effective new drug therapies have been introduced. In the future, gene therapies and a greater understanding of the biochemical basis of heart disease are likely to prevent even more cases of heart disease, reducing the need for invasive surgery and enabling people to live longer healthier lives.

- **More than half of the elderly will develop cataracts, but cataracts are rarely debilitating any more.** Left untreated, cataracts can be very disabling - with reduced vision it is difficult to work, read, and participate in many other activities of life. During the 1970s, surgical treatments for cataracts were developed, but the procedures were long, unpleasant, costly, and restored only fair eyesight. Over the past 15 years, cataract removal and lens replacement has become a routine outpatient procedure, and has restored very good eyesight to millions of older Americans.

IMPROVING HEALTH OF OLDER AMERICANS:

AMERICANS ARE LIVING LONGER THAN IN THE PAST:

- Americans are one-third more likely [83% vs. 60%] to reach age 65 now than they were when Social Security began, and they are more than three times as likely [35% vs. 10%] to reach age 85.

- Life expectancy for 65-year old Americans has increased by about one month per year for the past 60 years. A woman turning 65 in 1998 has a life expectancy of 20 more years; a man can expect to live an additional 16 years.

THESE IMPROVEMENTS IN LIFE EXPECTANCY ARE LIKELY TO CONTINUE:

- The increase in life expectancy of older Americans since 1940 can be traced mainly to reduced mortality from heart disease and stroke. Both improvements in disease prevention (especially before 1980) and improvements in medical treatments for heart disease (especially since 1980) have accounted for the reduced mortality.

- New innovations in the treatment of heart disease and stroke, and new knowledge about preventing these diseases and their complications, suggest that reductions in cardiovascular death rates will continue.

- Mortality from other diseases may also decline in the future. Death rates from cancer have increased slightly since 1949. However, cancer death rates have fallen for the last several years. Many new innovations in cancer treatment, such as greater use of mammograms to detect cancers early as well as genetically-engineered drugs that inhibit the blood vessels supplying cancers, provide some promise that these declines will continue.

- Many experts believe that these trends will result in continued steady improvements in survival to the "oldest old" ages of 85 and beyond, and continued increases in life expectancy.

QUALITY OF LIFE IS IMPROVING ALONG WITH LENGTH OF LIFE FOR OLDER AMERICANS:

- An increasing share of elderly Americans report themselves to be in good to excellent health. As the Table below shows, Americans aged 75 and over now report their overall health to be about as good did Americans aged 65-74 a decade earlier. In turn Americans 65-74 now report their health to be about as good as did Americans aged 55-64 a decade earlier.

PERCENT RATING OWN HEALTH AS EXCELLENT, VERY GOOD, OR GOOD, BY AGE

	55-64	65-74	75+
1984	74.6	67.8	64.1
1994 (most recent year available)	79.7	74.4	68.7

- Most studies have found that objective measures of the physical and cognitive health of the elderly have also improved.

- The additional years of life that older Americans are experiencing do not appear to be years spent with serious morbidity from severe functional impairments. Some studies find that serious morbidity has even been "compressed" into a shorter time period before death, and that the likelihood and length of nursing-home stays has not increased.

DESPITE THESE SUBSTANTIAL IMPROVEMENTS IN HEALTH, THE HIGH RATES OF CHRONIC ILLNESSES AND DISABILITY IN OLDER AMERICANS REMAIN IMPORTANT CONSIDERATIONS FOR POLICIES AFFECTING RETIREMENT AND SOCIAL SECURITY:

- Around 1/5 of the elderly need help with at least one activity of daily living, and 1/20 live in nursing homes. These rates increase substantially with age: half of those aged 85 and over need assistance with at least one activity of daily living, and most nursing home residents are in this age group.

- The rates of many chronic illnesses in elderly Americans – including arthritis, hearing or vision impairments, heart failure, diabetes, and many others – are at least twice as high for the elderly as for the nonelderly.

- The rates of most of these illnesses have not declined in proportion to the mortality improvements, suggesting that many of the elderly are living more effectively despite chronic health problems. For example: better joint replacement procedures have improved the mobility of the elderly with arthritis; devices and procedures to improve hearing and vision have substantially improved sensory capabilities; and better drug treatment for the complications of heart failure has improved the physical capacity of the elderly with heart failure.