

**Statement**

**Before the**

**House Committee on Ways and Means  
Subcommittee on Social Security**

**The Fourth Hearing in the Series on**

**“The Future of Social Security for this Generation and the Next”**

**by**

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**Statement of Kelly Olsen and Paul J. Yakoboski  
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**Summary**

The 1997 Social Security Trustees report that, under intermediate assumptions, Social Security outgoes will exceed income beginning in the year 2018. However, since 1983, the Trustees' projections as a whole have tended to be optimistic. Given that the mortality assumptions currently used by the 1997 Social Security Trustees are optimistic in comparison with assumptions used by other government entities and academics, there may be reason to believe that Social Security outgo will exceed income before 2018.

The importance of considering any projected Social Security shortfall as serious is underscored by the program's role in the income of the older population. Because over 60 percent of the elderly depend on Social Security benefits for at least one-half of their income, Social Security is the single most important income source for aged Americans.

While disagreement and uncertainty surrounds the degree to which reform is *necessary*, the degree to which *fundamental* reform is *desirable* presents a more contentious policy issue for Congress. Individual, participant-directed Social Security accounts are central to nontraditional reform approaches. Using individual accounts could increase program revenue by allowing participants to invest Social Security funds in equities, which have provided higher rates of return, on average, than the Treasury bonds in which the government currently invests Social Security funds.

The following three issues surrounding individual accounts will prove to be critical as the reform debate ensues.

- *Would individual Social Security account balances be paid out in the form of annuities or lump-sum distributions?* Results from the annual Retirement Confidence Survey, co-organized by EBRI, the American Savings Education Council, and Mathew Greenwald & Associates, reveal that most retirees do not purchase annuities. Moreover, the effectiveness of the majority of retirees at managing their savings throughout retirement is unknown.
- *Would Congress allow access to individual account funds for purposes other than retirement?* If Congress allows preretirement access, this decision will surely have negative implications for retirement income security.
- *Would Congress be comfortable with people at the same income level and of the same demographics receiving different levels of Social Security benefits under a national retirement system? In addition, would it be acceptable for some individuals to end up with no individual account balance to supplement a reduced Social Security base benefit?* EBRI research shows that similar people invest their Social Security funds differently, and are therefore likely to have different individual account balances at

retirement. Using the data behind this conclusion, EBRI will explore the actual disparities likely to occur in a system of individual Social Security accounts through the EBRI-SSASIM2 policy simulation model, the cornerstone of EBRI's Social Security Reform Analysis Project.

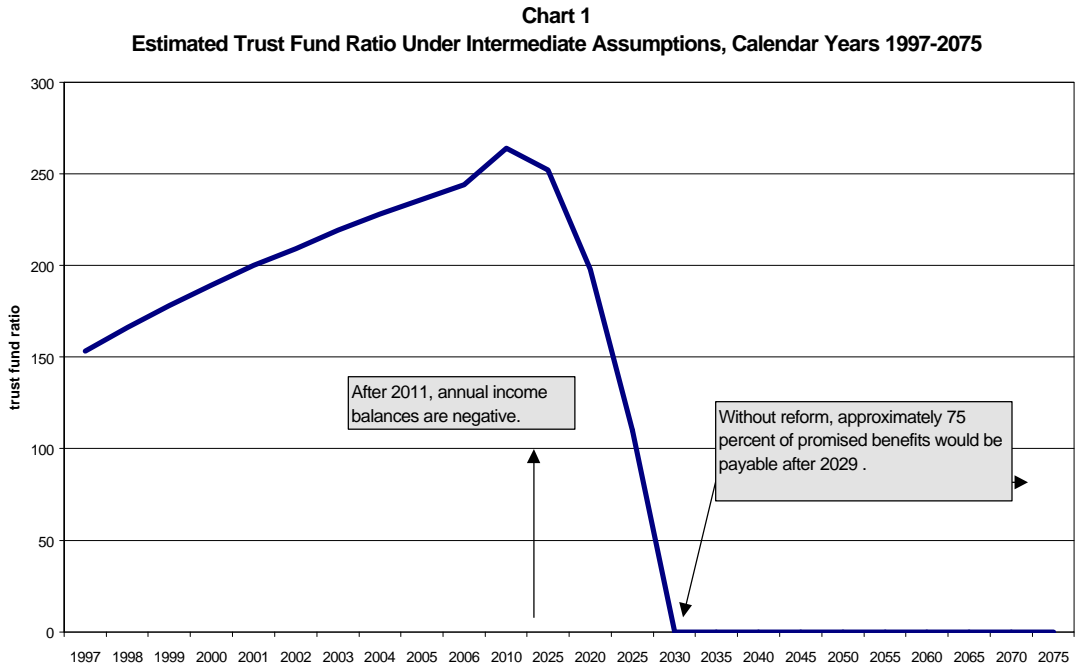
Congress is now and will continue to be inundated by multiple reform proposals coming from a range of perspectives. The additional uncertainty surrounding the introduction of individual Social Security accounts will make this round of the Social Security reform debate more complex than its predecessors. The EBRI-SSASIM2 policy simulation model is designed to provide a value-neutral scorecard for all types of reforms, to which policymakers and the public can subject their own objectives and values. We look forward to presenting the Committee and its staff with results from our model.

We are pleased to appear before you this morning to discuss issues of Social Security reform. I am Kelly Olsen, a research analyst with the Employee Benefit Research Institute (EBRI) and seated beside me is Paul Yakoboski, a senior research associate with the Institute.

Since its founding in 1978, EBRI has been committed to the accurate statistical analysis of economic security issues. Through our research, we strive to contribute to the formulation of effective and responsible health and retirement policies. For the past year, we have been conducting a Social Security Reform Analysis Project to provide policymakers, the media, and the public with value-neutral analysis of reform options. Consistent with our mission, we do not lobby or advocate specific policy solutions.

To What Degree Is Social Security Reform Necessary?

The 1997 Social Security Trustees report that, under intermediate assumptions, Social Security outgoes will exceed income beginning in the year 2018. The Trustees predict that by 2029, the combined Old Age, Survivors, and Disability Insurance (OASDI) trust funds will be exhausted, and FICA income alone will be able to pay approximately 75 percent of promised benefits (Chart 1). Over the next 75 years, Social Security’s shortfall is projected to equal 2.23 percent of taxable payroll.



Source: 1997 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds (Washington, DC: Social Security Administration: 1997).

Projections under the Trustees’ intermediate assumptions, however, are not necessarily fully reflective of the program’s future experience. In fact, since 1983, the Trustees’

projections as a whole have tended to be optimistic. Variation between projections and actual experiences has occurred in part because projections depend on many assumptions about the future. These assumptions introduce a large element of uncertainty. For example, the 1997 Social Security Trustees project the trust funds will experience anywhere from a 0.2 percent surplus to a 5.54 percent shortfall under three scenarios, each of which is based on what many experts believe to be reasonable actuarial and economic assumptions. Several of these assumptions are controversial. In addition, outcomes are quite sensitive to the value chosen for some assumptions in that small differences in value can translate into vastly different policy projections.

Mortality rates are one of the most controversial assumptions used in projecting Social Security’s long-range financial status. In addition, projections are quite sensitive to different mortality values. Clearly, the longer people live, the more pressure will be placed on Social Security finances. The mortality assumptions used by the 1997 Social Security Trustees appear rather optimistic in comparison with mortality assumptions used by other government entities and academics (Chart 2).

**Chart 2**  
**Alternate Estimates of US Population Ages 85 and Older in 2050**  
 (All estimates are expressed in millions of people)

| <i>Estimate Source</i>          | <i>Population 85+</i> |
|---------------------------------|-----------------------|
| Census Bureau (low)             | 9.6                   |
| Olshansky*                      | 11.4                  |
| Trustees Report (low) ♦         | 11.8                  |
| Trustees’ Report (intermediate) | 14.6                  |
| Trustees’ Report (high) ♦       | 17.8                  |
| Census Bureau (mid)             | 18.2                  |
| Lee*                            | 21.4                  |
| Census Bureau (high)            | 31.1                  |
| Vaupel*                         | 39.0                  |
| Manton*                         | 48.7                  |

Source: Census Bureau estimates were published in February 1996. Research by sources marked with an asterisk (\*) have been supported by the National Institute on Aging. Estimates marked with a diamond (♦) are produced by the EBRI-SSASIM2 model; all others are drawn from information supplied by the National Institute on Aging.

Should the Trustees’ mortality assumptions prove optimistic by actual experience, the year that programmatic outgo exceeds income could be pushed ahead from 2018 to an earlier date. Likewise, the trust fund could be exhausted several years earlier than 2029, and FICA income exclusively might be able to cover fewer than 75 percent of benefits promised thereafter. However, only time will ultimately tell the degree to which Social Security reform is necessary.

The importance of considering any projected Social Security shortfall as serious, however, is underscored by the program’s role in the income of the older population.

Because over 60 percent of the elderly depend on Social Security benefits for at least one-half of their income, Social Security is the single most important income source for aged Americans. With the average annual benefit in 1997 at \$8,940, the average beneficiary is maintained at just above the poverty level by Social Security. Although income from personal savings, employment-based pensions, and possibly earnings are supposed to supplement Social Security benefits for all retirees, these sources significantly supplement the Social Security benefit of primarily those among the uppermost income quintile. In fact, just 20 percent of the elderly population received a total income over \$22,254 in 1995.

### An Assessment of the Advisory Council's Recommendations and Other Reform Proposals

While disagreement and uncertainty surround the degree to which reform is *necessary*, the degree to which *fundamental* reform is *desirable* presents a more contentious policy issue for Congress. Individual, participant-directed Social Security accounts are central to nontraditional reform approaches. While the use of individual accounts is not a *necessary* condition for resolving the program's projected shortfall, a majority of the 1994–96 Social Security Advisory Council members agreed that this approach is more *desirable* than reforms that would exclusively fix the system by raising taxes and cutting benefits. Individual account reforms, which have been proposed by numerous other groups, are receiving a great deal of policy and media attention. As a result, the issues surrounding individual accounts have found new importance in the Social Security reform debate.

One important issue associated with individual Social Security accounts is whether benefits would be paid out in the form of annuities or lump-sum distributions. By conducting the annual Retirement Confidence Survey, co-organized by EBRI, the American Savings Education Council, and Mathew Greenwald & Associates, we found that only 21 percent of surveyed retirees annuitized their IRA balances, and just 12 percent annuitized their distributions from other retirement plans such as 401(k) plans. Given that most retirees do not purchase annuities, we do not know how effective the majority of retirees are at managing their savings throughout retirement. This lack of knowledge raises the following questions when considering creating a system of individual Social Security accounts: how much confidence should we have in retirees' ability to manage balances from individual Social Security accounts if Congress does not require these balances to be annuitized? If annuitization is not required, how effective can we expect individual Social Security accounts to be in providing retirement income throughout a person's retirement years?

Another issue central to individual Social Security accounts is whether Congress would allow access to individual account funds for purposes other than retirement. If individual Social Security accounts were to become the largest source of assets for most households, would voters demand access to their accounts through lump-sum distributions in times of financial hardship? If not, would Congress be comfortable letting people with large

individual Social Security account balances to be evicted from their homes or be unable to afford critical medical care because they do not have access to their balances prior to retirement? On the other hand, if Congress allows preretirement access, this decision would surely have negative implications for retirement income security.

While lump-sum distribution and preretirement access issues are critical to the assessment of individual Social Security accounts, we would like to focus most intensively today on one largely unexplored aspect of individual account reforms: the increased uncertainty in individual’s benefits due to differences in their investment behavior. Clearly, if a participant’s Social Security benefit is tied to the balance of his or her individual Social Security account, it is important to ascertain how persons are likely to make investment decisions. It is unfortunate that to date, realistic investment data have been unavailable. As a result, all researchers who have studied Social Security reform outcomes under a system of individual Social Security accounts have assumed that each age cohort invests in exactly the same manner in terms of asset allocation.

Through EBRI’s Employee Understanding Project, we have gathered the largest known database of individual investment data from a number of private pension plan sponsors and from investment firms. Although the Project is ongoing, preliminary results show that different people—even people who have similar demographic characteristics and participate in the same retirement plan—invest their money in very different ways. Hence, while these data are informative, they do not show much detail on the variation of investment preferences among workers. For example, we have found that within one employer’s retirement plan, a sizeable fraction of participants do not invest any funds in equities, while another fraction has invested heavily in equities (Table 3).

**Table 3**  
**Allocation Distributions of Participant Account**  
**Balances in One Large Employment-Based Retirement Savings Plan, 1994**

| Total Participants (as a Percentage) | Equity Investments |      |         |      |
|--------------------------------------|--------------------|------|---------|------|
|                                      | Zero               | <20% | 20%-80% | 80%+ |
| Total                                | 25.4               | 7.1  | 47.8    | 19.7 |
| Ages 20-29                           | 19.8               | 7.4  | 48.5    | 24.3 |
| Ages 30-39                           | 20.0               | 6.5  | 51.5    | 22.0 |
| Ages 40-49                           | 24.9               | 7.5  | 47.5    | 20.2 |
| Ages 50-59                           | 31.7               | 6.7  | 45.5    | 16.1 |
| Ages 60 and Older                    | 55.2               | 8.1  | 31.4    | 5.2  |

Source: Employee Benefit Research Institute, *Issue Brief* Number 176, August 1996.

In one large company, we found that almost 20 percent of participants ages 20–28 held no equity investments, while almost a quarter were heavily diversified in equities. Interestingly, the “problem” explaining this plan’s large variance in investment behavior is not due to a lack of participant education, as this particular employer has a sophisticated employee investment education program.

From this example, we can logically conclude that different people—often of the same socioeconomic group—are going to receive different returns on their individual Social Security accounts. A first question for Congress to consider then becomes: are you comfortable with people at the same income level and of the same demographic characteristics receiving different levels of Social Security benefits under a national retirement system? A second question: would it be acceptable for some individuals to end up with no individual account balance to supplement a reduced Social Security base benefit?

### Recommendations for Congress to Consider as it Moves Forward

For some of you, the answer to these questions hinges on ascertaining the likelihood that different people will receive vastly different benefits under a system of individual Social Security accounts. The EBRI-SSASIM2 policy simulation model will soon present quantitative results on this issue. The model will be able to do so because of its unprecedented capabilities for modeling individual accounts as well as its ability to account for uncertainty under a range of possible economic and demographic scenarios, such as different mortality rates. In addition, the information EBRI has obtained from its Employee Understanding Project will be included in order to show how realistic individual investment patterns would affect disparities between individual benefit amounts under an individual Social Security accounts system.

Congress is now and will continue to be inundated by multiple reform proposals coming from a range of perspectives. The additional uncertainty surrounding the introduction of individual Social Security accounts will make this round of the Social Security reform debate more complex than its predecessors. The EBRI-SSASIM2 policy simulation model is designed to provide a value-neutral scorecard for all types of reforms, to which policymakers and the public can subject their own objectives and values. We look forward to presenting the Committee and its staff with results from our model. Thank you.