2. SAVING SOCIAL SECURITY

> *"For 60 years, Social Security has meant more than an ID number on a tax form, more than even a monthly check in the mail. It reflects our deepest values, the duties we owe to our parents, to each other, to our children and grandchildren, to those who misfortune strikes, to our ideals as one America."*
>
> President Clinton
> April 1998

Social Security is one of the most successful Government programs in United States history. Since its creation more than 60 years ago, Social Security has formed the bedrock of retirement security for Americans. Social Security is more than a retirement program, though. It is a promise, a guarantee. For millions of Americans who grow old after a lifetime of work, who become disabled or suffer the death of a family breadwinner, Social Security has meant that America will stand by them.

Right now, the future of Social Security is uncertain. The pending retirement of 76 million baby boomers will put new financial pressure on the Social Security system. By early in the next century, the Social Security trust fund will have to start drawing on its own reserves in order to pay beneficiaries, reversing the self-financing nature of the system that has existed since its inception. As this trend continues to grow, some thirty years into the 21st Century, Social Security will have only enough resources to cover 72 cents on the dollar of currently promised benefits. Put simply, if no changes are made, Social Security will eventually go broke.

In order to preserve the system that so many Americans rely upon, the President is urging the Nation to take measures this year. In 1998, he has led the way with a series of regional bipartisan forums to build public awareness about the nature and scope of the problem, and to build public consensus for solutions.

This year, the Administration intends to work with Congress on a bipartisan basis to fix Social Security, guided by the five principles he stated last year. The time to act is now. First, if we take measures today, the changes to fix Social Security will be far simpler than if we confront the problem after it has grown. Acting now provides the opportunity to take advantage of America's strong economy and the Government's first budget surpluses in a generation. The future of Social Security presents a huge challenge for America, but with serious effort and bipartisan engagement, it is a challenge we as a Nation are well prepared to meet.

A Long-term Commitment to Workers and Their Families

Nearly every American is touched by Social Security at some point in their lives, either as a recipient of benefits or as a relative of a beneficiary. Social Security, officially known as Old-Age, Survivors, and Disability Insurance (OASDI), provides families with comprehensive protection against loss of income due to the retirement, disability or death of a wage earner.

While most Social Security beneficiaries are retired workers, Social Security is more than a retirement program. Nearly one third of Social Security beneficiaries are disabled workers and their families, or survivors of deceased workers (see Table 2–1). Many beneficiaries would face a high risk of poverty without the income protection provided by Social Security.

Principles for Social Security Reform

The President has announced five principles with which to evaluate proposals for correcting Social Security's long-range imbalance.

First, any reform should strengthen and protect Social Security for the 21st Century. The basic program has been one of this Nation's greatest successes, and it should not be abandoned.

Second, reform should maintain universality and fairness in the program. For half a century, Social Security has been a progressive guarantee for citizens.

Third, Social Security must provide a benefit that people can count on. Regardless of the ups and downs of the economy or the financial markets, Social Security must provide a solid and dependable foundation of retirement security.

Fourth, Social Security must continue to provide financial security for disabled and low-income beneficiaries. Social Security is not just a retirement program. It is also a disability insurance and life insurance program. One out of three Social Security beneficiaries is not a retiree.

Fifth, Social Security reform must preserve America's fiscal discipline.

When President Roosevelt signed Social Security into law, most seniors were poor. Shortly before Roosevelt established the program, one elderly person sent a letter begging him to end the "stark terror of penniless old age." Since then, Social Security benefits have significantly improved the well-being of the Nation. The poverty rate among the elderly declined by 64 percent over the past three decades, in large part due to Social Security. In 1967, 29.5 percent of the Nation's senior citizens lived in poverty. By 1997, that figure had dropped to 10.5 percent.

Social Security was founded on two important principles: social adequacy and individual equity. Social adequacy means that benefits will provide a certain standard of living for all contributors. Individual equity means that contributors receive benefits directly related to the amount of their contributions. These principles still guide Social Security today.

Social Security was originally designed to provide a continuing source of income to help eligible workers maintain a household when they retired. In 1935, personal savings, family support, and State welfare programs were the main sources of income for those age 65 and older who did not work.

Table 2–1. SOCIAL SECURITY PROVIDES UNIVERSAL BENEFITS
(Thousands of OASDI Beneficiaries)

	2000 Estimate
Retired workers and families:	
Retired workers	27,941
Wives and husbands	2,850
Children	447
Survivors of deceased workers:	
Children	1,932
Widowed mothers and fathers with child beneficiaries in their care	214
Aged widows and widowers, and dependent parents	4,822
Disabled widows and widowers	193
Disabled workers and families:	
Disabled workers	4,939
Wives and husbands	186
Children	1,459
Total	**44,983**

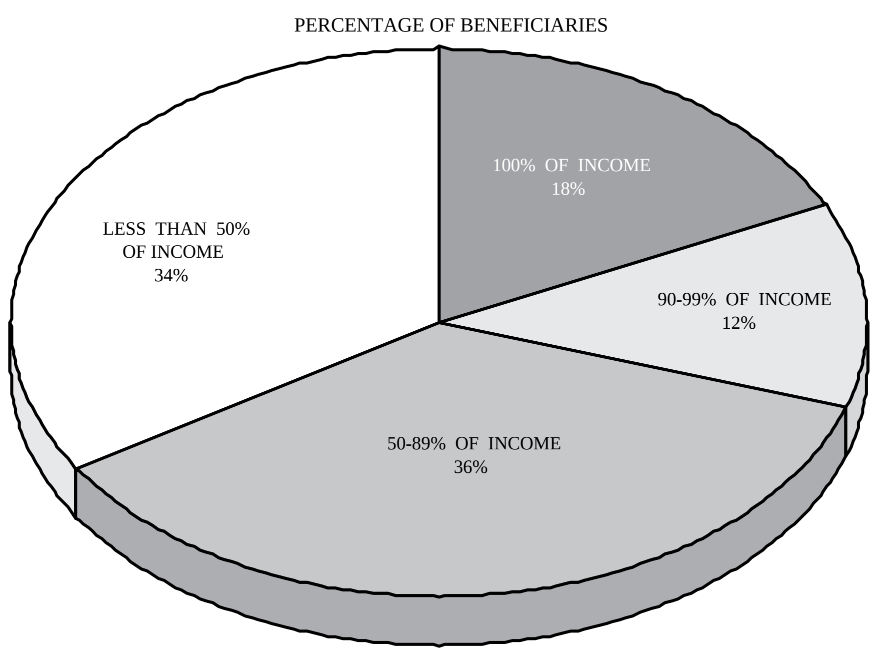
Before Social Security, about half of those over 65 depended on others, primarily relatives and friends, for all of their income. The same was often true for people with disabilities. Today, two thirds of those over age 65 get at least half of their income from Social Security (see Chart 2–1). Social Security benefits account for about 40 percent of all income that goes to the elderly population. For an average-wage worker retiring in 1998, Social Security replaced more than 40 per cent of his or her pre-retirement earnings. With Social Security, the vast majority of those over age 65 and those with disabilities can live relatively independent lives. Moreover, their families no longer carry the sole responsibility of providing their financial support.

Disability Insurance (DI) provides income security for workers and their families when workers lose their capacity to work due to disability. Before DI, workers often had no such protection, although in some cases employees whose injuries were job-related may have received State worker's compensation benefits. Congress enacted DI in 1956 to protect the resources, self-reliance, dignity, and self-respect of those suffering from non-work-related disabilities. DI protection can be extremely valuable, especially for young families who could not sufficiently protect themselves against the risk of the worker's disability.

Social Security is especially important for women, who make up 60 percent of all Social Security beneficiaries, and an even greater percentage—72 percent—of all beneficiaries over age 85. Benefits to spouses of retirees and survivors of deceased workers are a critical source of old-age income for women, who are more likely to take time out of the paid workforce to raise children or care for aging parents.

Social Security also makes up a larger share of retirement income for women than it does for men. The program accounted for 51 percent of the total income of elderly unmarried women in 1996, including widows. It provided 39 percent of the income of

Chart 2-1. SHARE OF OASI BENEFICIARIES WHO RELIED ON SOCIAL SECURITY FOR A GIVEN PORTION OF THEIR INCOME, 1996



elderly unmarried men, and 36 percent of income of elderly married couples. Moreover, women are more likely to rely on Social Security for all of their retirement income (see Table 2–2).

Social Security plays a larger role in women's retirement income than men's for several reasons. First, women live longer on average, and the inflation-indexing of Social Security benefits protects their buying power over time. Second, women on average have lower lifetime earnings than men due to the fact that women in general take more years out of the work force, are more likely to work part-time, and are more likely to earn lower wages than men, even in year-round full-time work. Because women have lower earnings, the progressive nature of the Social Security benefit formula enhances the role of these benefits in women's retirement income. Finally, women are less likely than men to retire with private pensions, and their pensions are smaller than those received by men, again due to lower lifetime earnings. While the differences between men's and women's work patterns and earnings are expected to shrink in next few decades, they are not expected to disappear entirely.

Program Trends

Growth in Retirement Benefits: Social Security is facing financial stress due to changing demographics and its own financing structure. The program is largely "pay-as-you-go"—current retirement benefits are financed by current payroll contributions. Such financing worked well in the past, when five workers paid for every retiree. However, when the large baby boom generation retires, eventually only two workers will pay for every retiree (see Chart 2–2). Furthermore, while the system's financial burden will increase greatly with the baby boomers' retirement, the Social Security Trustees do not expect demographic trends to improve markedly in later periods.

Two demographic factors are especially important. Baby boomers and subsequent generations are having fewer children and are expected to live longer than previous generations. In 1957, women had an average of 3.7 children, compared to 2.02 today. In 1935, life expectancy was 63 years for females, 60 for males. By contrast, baby boomers on average have a much longer life expectancy—73 years for females and 67 for males. The life expectancy for people born in 2000 is 80 years for females, 74 years for males. The longer people live, the longer they will collect Social Security. The longer that people spend in retirement, the larger the pool of retirees who need to be supported at any one time, and the fewer there are working who can contribute to provide that support.

Growth in Disability Benefits: Social Security's disability component has grown rapidly since its inception. The program provided about $48 billion to 6.2 million disabled beneficiaries and their family members in 1998, compared to $57 million for 150,000 disabled workers in 1957.

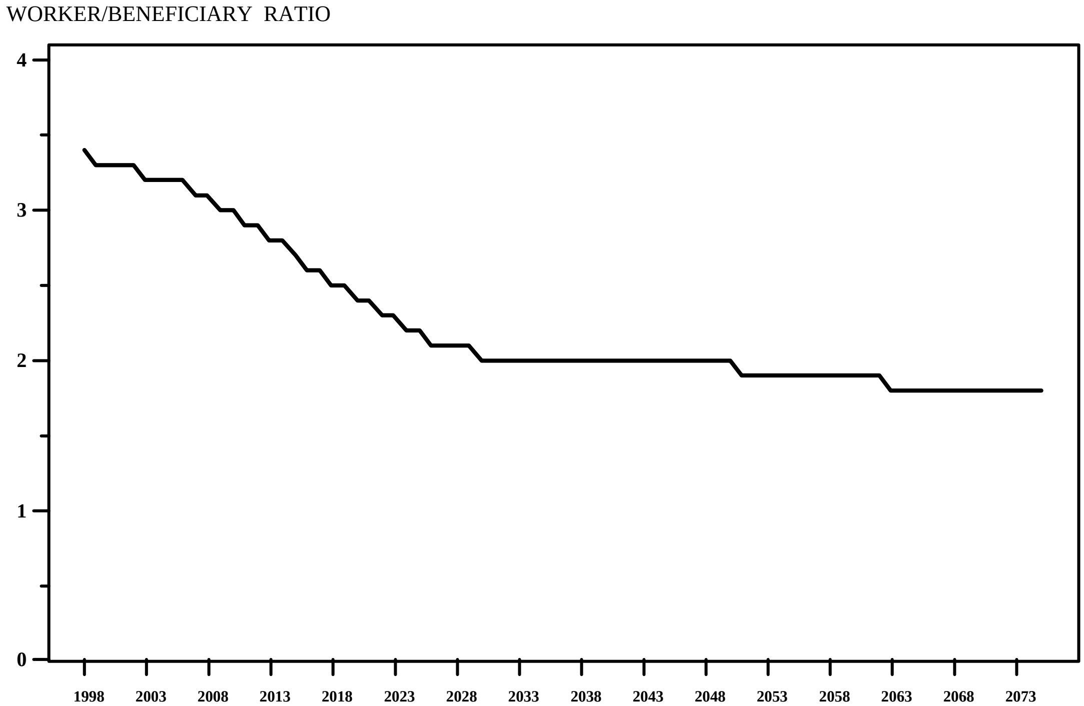
What has caused the program growth? Laws, regulations, and court decisions over the years have expanded eligibility for benefits. Recently, more and more baby boomers are reaching the age at which they are increasingly prone to disabilities, and the number of women insured has risen. As the caseload grows, it becomes more important

Table 2–2. SOCIAL SECURITY IS CRUCIAL TO RETIREMENT INCOME

(Percentage of those over age 65 who relied on Social Security for their entire income, 1996)

	Social Security is sole income source
Unmarried women	25%
Unmarried men	20%
Married couples	9%

Chart 2-2. COVERED WORKERS PER SOCIAL SECURITY BENEFICIARY



to ensure that those on the rolls are all, in fact, eligible for benefits. To maintain DI's integrity, the Administration proposes to maintain support for additional continuing disability reviews—periodic reviews of individual cases that ensure that only those eligible continue to receive benefits.

In any given year, very few DI beneficiaries return to work. Many are just too severely disabled to work. Others, however, could work and want to work, but they face significant obstacles to doing so. To address this problem, the budget includes a comprehensive package of proposals to help disabled beneficiaries enter or re-enter the work force (see Chapter 3, "Investing in Education and Training").

The Long-range Challenge

Social Security is designed to be self-financed; its most important revenue source is the payroll tax. Current economic and demographic forecasts indicate, however, that revenues will fall short of expenditures in the next century unless corrective action is taken. The combined OASI and DI trust funds are not in balance over the next 75 years—the period over which the Social Security Trustees have traditionally measured Social Security's well-being. The projected financial shortfall is largely due to the demographic trends discussed above. In their 1998 report, the Trustees estimated that starting in 2013, annual tax revenues coming into the trust funds will fall short of benefit payments.

For many years, annual tax revenues going into the combined trust funds have exceeded benefit outlays, a situation projected to continue through 2012. The excess revenues are invested in special interest-bearing Treasury securities. These securities, like regular Treasury securities, are backed by the full faith and credit of the U.S. Government. The trust funds are credited with the amount of principal as well as the interest paid on the securities. However, with no changes to current law, beginning in 2013, the program will use interest income from these trust fund reserves to help pay benefits. Starting in 2021, payroll tax and interest income will no longer be sufficient. The program will need to spend the principal held in reserve in order to meet benefit obligations. The Trustees forecast that the reserves will run out in 2032. At that point, annual payroll tax revenue will be sufficient to pay about 72 percent of benefits promised under current law.

The long-range fiscal health of the trust fund is determined by economic as well as demographic factors. Such things as productivity improvements contribute to economic growth, which in turn bolsters revenues coming into the trust funds as workers enjoy low unemployment rates and higher real wages. However, even under optimistic assumptions about future productivity improvements and real wage growth, the demographic forecasts indicate that there simply will not be enough workers in the labor force to cover the expected retirement costs of the baby boom and subsequent generations.

The President believes it is critical to address this financing shortfall now, for several reasons. First, addressing the issue now expands the number of options available for dealing with the problem. Second, there is time to engage in careful deliberation and develop a well-thought-out plan that protects vulnerable populations. Third, the healthy American economy and existence of a budget surplus provides a rare opportunity to tackle the problem from a position of strength. Finally, making decisions now will allow individuals sufficient time to adjust their retirement planning, if necessary. Guided by the principles he described last year, the President believes the Administration and Congress can fulfill America's long-standing promise to future generations.

The President's Framework to Save Social Security

In his State of the Union address, the President unveiled his proposal to save Social Security by using some of the projected budget surplus to strengthen the system and by investing a portion of the surplus in equities to raise the rate of return. These actions will substantially improve the program's fiscal position, strengthening it until mid-century. It will require tough choices and a bipartisan approach to fix Social Security, and to reach the President's overall goal of saving the Trust Fund at least until 2075. During this year, the President will work with the Congress to restore the system to fiscal health, and to address his other priorities including protections for the elderly at high risk of poverty.

Devote 62 percent of the budget surplus for the next 15 years to Social Security: The Administration proposes to set aside 62 percent of the projected unified budget surplus of the next 15 years for Social Security. This amounts to more than $2.7 trillion in additional resources available to meet future Social Security benefit obligations.

Increase returns through private investment: The Administration proposes tapping the power of private financial markets to increase the resources to pay for future Social Security benefits. Roughly one-fifth of the unified budget surplus set aside for Social Security would be invested in corporate equities or other private financial instruments. Because only about one-fifth of the surplus set aside for Social Security would be invested in equities, the share of the stock market held by the Trust Fund would be limited. A mechanism to insulate investment decisions from political considerations would be developed. Under this plan, most of the surplus funds set aside for Social Security would continue to be invested in special Treasury securities.

Provide additional fiscal reforms: The proposals described above will extend the life of the Social Security Trust Fund until 2055—but do not achieve the President's goal of saving Social Security for 75 years. The President has called for a bipartisan effort with all to make the difficult, but sensible and achievable choices to save the system through 2075.

Reduce elderly poverty: Although Social Security has made great strides in reducing poverty in the past 30 years, some groups among the elderly still face high poverty rates. Elderly widows, for example, experience a poverty rate of 18 percent, nearly eight percentage points higher than the general population of the same age group. The President will work to see that Social Security protections for elderly women and other especially vulnerable beneficiaries are improved.

Encourage work: Social Security's rules discourage retired individuals from working because benefits are reduced when a retiree's earnings exceed a certain level. In 1996, the President and the Congress raised that level of earnings—so that by the year 2002, retirees could earn as much as $30,000 before their benefits would be affected. The President believes that an overall Social Security solvency agreement should remove the barriers to work that are a result of the earnings test.

Pay down the debt: This program will continue the Administration's policy of fiscal responsibility, through which, for the first time in 29 years, the Federal Government last year actually reduced the amount of debt that it must finance with the public. The contributions to the Social Security Trust Fund will further reduce the level of publicly-held debt by two-thirds, to the lowest percentage of GDP since 1917. This will add to the Nation's savings and help our economy continue to grow.