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Mr. Chairman and Members of the Committee:

Thank you for inviting me to testify before your Committee on issues regarding individual accounts under a reformed Social Security system and ways to resolve these issues.

In my testimony today you have asked me to focus on three topics. First I examine strengths and weaknesses of our current retirement income system that are pertinent to discussions of how women fare in retirement. Second I discuss some of the objections raised in connection with adding an individual account component to our old-age income system. And third, I outline how one might construct a reformed system that includes individual accounts, one that would meet some of the objections raised. To preview my conclusion, I argue that it is possible to add an individual saving account pillar to our national retirement system, in a way that addresses many of the problems inherent in the current system.

>OUR NATION'S RETIREMENT INCOME SYSTEM HAS BOTH STRENGTHS AND WEAKNESSES

The US retirement income system has strengths but it also has many important weaknesses. There is no doubt that Social Security, employer pensions, and individual provision for old age combine to make a strong, flexible, and diversified set of mechanisms protecting the elderly. Optimists argue that our system is working well, pointing to the drop in elderly poverty rates since the 1960's, the fact that more Americans can afford to retire earlier than ever before in our history, and the impressive accumulation of employer-provided pension wealth. This positive picture of the nation's retirement system is complemented by the efforts to boost retirement saving in recent years including 401(k), IRA, and Roth retirement plans, rules requiring faster vesting and joint/survivor options under private pensions, and measures taken to strengthen the nation's defined benefit pension system. Most agree that the prospect of growing old in America today is more appealing than it was in the 1930's.

Despite this positive assessment of the retirement landscape, pessimists emphasize the deep and growing problems confronting our national retirement system. The Social Security system faces critical solvency problems over the next few decades. Concerns abound regarding employer pensions as well: there has been little growth in private coverage for over a decade, and many people offered pensions turn them down, for reasons only poorly understood. And as far as individual saving goes, Americans have done a poor job of building individual assets, despite the fact that the period of time we anticipate spending in retirement is growing longer. Moreover, many older persons still live at or below the poverty line, and still others face insecure economic circumstances associated with the death of a spouse, the onset of poor health, or the simple reality of living too long and spending down their assets.

It is against this backdrop that policymakers seeking to revamp the nation's retirement system are asked to focus on the particular situation of women. While most of the key provisions of our pensions, social security, and tax laws are explicitly gender-neutral, it is frequently argued that they do not "play out that way" in practice. For this reason, women have become a focus of attention in the retirement arena. There are two explanations given for this. First, women tend to live longer than men on average. Many married women will become widows and spend down their assets around the time their husbands pass away. Nonmarried women tend to have relatively low levels of assets to begin with, which combined with a long life expectancy places them at risk for economic insecurity in old age. Women's longer lifespan means that they are more vulnerable to inflation and health care problems than their male counterparts. As a result, and the second reason people focus on how the retirement income system affects women differentially, is that older women are more likely to be poor than are older men. If an "ideal" retirement income system were one that guaranteed some "safety net" or minimum consumption level, many older women as well as many men fall below this level in America today.

In my view, our old-age system has contributed to these problems because the philosophical perspectives structuring the system are outmoded and incoherent. To remedy these problems, it is essential to develop a comprehensive and updated framework for a national retirement income policy. In doing so we need to take a look at the underlying philosophies that have shaped what we have, along with the inherent conflicts between them.

The Earnings Replacement Approach

Much of our old-age system is structured around **earnings replacement**. This philosophy emphasizes that people earning more must save more, to ensure that retirement income does not drop too far below what they lived on while working. This was encouraged by the tax code which provides a greater tax break for higher earning people via company-sponsored pensions and IRA's. (Of course, nondiscrimination laws curb tax deferred saving for very high earners). Hence, too, the Social Security benefit formula was structured using an earnings replacement philosophy, to replace part of the worker's lifelong pay. Underlining the earnings-related focus of Social Security was the requirement that people could only receive benefits if they contributed a fixed number of years to the system (roughly 10).

Not surprisingly, the earnings replacement approach has produced a positive relationship between saving and earnings. That is, people with lower lifetime earnings - including lower skilled and part-time/part-year employees - save less, since they have less to replace. People with higher lifelong earnings have more in retirement. Also, anyone with a short time in the paid labor market - less than 10 years - is often ineligible for retirement benefits on his or her own record. The result of this approach is that many women retiring today are eligible for low, or no, benefits on their own account. Since today's older women as a rule spent few years in the paid labor market, and many of those who did earned low pay, they are less likely to have company pensions and individual retirement assets than older male retirees. [They are also less likely to be covered for disability benefits under SSDI as a result]. In the future, pension coverage and asset accumulations are expected to grow as women's earnings and years of paid employment increase.

Another result of the earnings replacement philosophy is that retirees are not guaranteed a minimum retirement income in our current system. In other words, people who experience low or erratic labor market earnings and employment over their lifetimes end up with low or no pension and social security at all. An alternative approach would be to guarantee all Americans some affordable minimum benefit, such as the poverty line, and then to construct the retirement income system so that this was achieved. Of course, this would require a change in the underlying philosophy of the retirement income system, one we describe below in more detail.

Redistribution and the Traditional Family Subsidy

Another philosophy underlying our national retirement income system is a **redistributive** one. One way this is seen is in the redistributive benefit formula that returns higher proportional benefits to low lifetime earners. Another example of this is that the system builds in a subsidy to one particular household type, namely the "traditional" family, which 60 years ago consisted of a husband-earner and a wife-homemaker who reared the children. At that time, marriages lasted longer than they do now -

generally until one spouse died - and the husband usually predeceased his wife. The designers of the Social Security system structured benefit rules to subsidize this traditional family by allocating a benefit to the nonworking wife worth half her husband's benefit. If she were widowed, she and her dependent children also received a survivor benefit. (Under Social Security benefit rules are gender-neutral, but most surviving spouses have been widows.)

Subsidizing traditional families under Social Security produces income redistribution toward households of one type - married couples where only one partner works for pay and the other raises children - and away from households of many other types. These others include households where both partners work for pay and households with nonmarried persons. In addition, under current rules, the system has a "length-of-marriage" requirement such that families with single parents cannot get dependent or widow benefits unless the marriage lasts for 10 years or more.

These rules appear quite arbitrary and unfavorable toward many women, in the current environment. Families today do not readily fit the traditional mold embedded in the Social Security benefit structure designed 60 years ago. Dramatic changes in marriage and divorce patterns, along with women's rising labor force attachment, have shrunk the group eligible for the traditional family subsidy under Social Security. For instance, divorce rates tend to peak at around seven years of marriage, leaving a large and growing fraction of the population uncovered by the traditional family subsidy. Some population groups have experienced dramatic declines in marriage rates, rendering them ineligible for spouse, dependent, and survivor coverage. Many working wives also receive no net benefit from paying the Social Security payroll tax their entire working lives, since their benefit as wives exceeds their benefit as retired workers. Though technically they are "dually entitled" (their own retiree benefits are topped up to the level they would receive as nonworking spouses), the reality is that no net retirement benefit at the margin results from their payroll tax payments. Hence the result is that in many households the system discourages rather than encourages work and saving. This is particularly troubling for lower-paid dual-earner households where holding a job is a necessity rather than an option; conversely, the traditional family subsidy tends to reward higher-income households where one spouse does not hold a paying job.

The Current System Faces Insolvency

Another problem confronting all older workers is that the current retirement income system faces insolvency. That is, under current rules, Social Security revenues are insufficient to maintain benefit promises into the future. Since women live longer in retirement than men, and a larger portion of their promised retirement benefits comes from Social Security than from other sources, many will feel particularly vulnerable to the shadow of uncertainty cast by the political and economic uncertainty created by not knowing how this insolvency problem will be resolved. Hence reforms instituted soon, even if they are phased in over time, will benefit women and their families.

The Current System Has Mixed Effects on Women

In sum, our national retirement income system has both positive and negative effects on women. Our mothers and grandmothers, who are today retired, benefited a great deal from the traditional family benefit philosophy guiding benefit rules. But the situation is different looking forward. Virtually all cohorts working today anticipate receiving less in benefits than taxes paid into the system. Furthermore, demographic and economic changes have meant that the retirement system imposes some of the heaviest marginal tax rates on working women, many who are finding that that the system does not meet their needs. In addition, the serious financial challenges confronting our Social Security system are undermining many Americans' confidence in the ability of the system to sustain promises made. Those of us anticipating being here over the next 50 years - many of us women - have a deep interest in seeing the system reformed soon, in a way that will put to rest much of this uncertainty.

IMPACTS OF A PERSONAL RETIREMENT ACCOUNT REFORM

Next we examine whether and how a personal retirement account approach could remedy some of these shortcomings in our national approach to retirement policy. I shall show that individual accounts are at worst neutral toward women, and they could even improve women's retirement income security.

There are many specific individual account plans in the works, including some under construction by key members of this Committee. Rather than exploring the specifics of any particular plan, I draw on my observations gleaned from serving as co-chair of the Technical Panel on Income and Retirement Saving for the last Social Security Advisory Council. There it was argued that a viable individual account approach would involve mandatory payroll contributions to a funded, individually-directed, defined contribution pension plan. Some choice of investment options would be permitted, initially probably limited to a handful of broad index funds, with government regulatory oversight and reporting.

In the course of that work we explored the pros and cons of personal saving accounts from many angles. I organize the most commonly hear objections to individual accounts into two groups, those associated with the accumulation phase (prior to retirement) and those associated with the decumulation phase (after retirement).

Issues in the Accumulation Phase

Taking these in order, during the *accumulation* phase, concerns are sometimes expressed about the following. I attach my observations immediately following each point:

1. Low-wage workers, and people with modest attachment to jobs covered by Social Security, would contribute relatively little to their personal saving accounts. This could produce a low accumulation by retirement.

Comment: Women's average earnings and years in the labor force are lower than men's, so women on average would receive lower benefits than men from these accounts, a result in keeping with the earnings replacement philosophy outlined above. Of course, gaps in earnings and labor force attachment are narrowing by sex, so these concerns will be mitigated in the future. In addition, people with very low accumulations would be covered by the minimum benefit alluded to above; by contrast, there is no minimum guaranteed benefit provided under the current system.

2. Participants might make poor investment choices, take out loans against their accounts, or cash out the lump-sums in their accounts, potentially undermining the purpose of the individual accounts.

Comment: Today's women are not more likely to cash out, take loans from, or misinvest, their pension assets, judging from available evidence. Pension participants can also be educated about the benefits of pension saving and financial issues, and women should be as likely as men to be educable in an individual accounts context. Again, those who did so would be covered by the minimum benefit provision, providing a safety net not available under the current system.

3. Homemaker spouses who never held a paying job would have no contributions to their personal accounts.

Comment: The number of homemaker spouses without a paying job is falling over time, and individual account balances have the virtue of continuing to grow during periods out of the labor force, unlike the current Social Security rules that reduce benefits for nonworking years. Further, individual accounts could be bequeathed in the event of the husband's death. Some personal account plans also guarantee a minimum benefit ("demogrant") to all older Americans, a feature lacking under the current system.

4. In the event of divorce, individual account balances might not be equitably split between the two parties.

Comment: Just as private pension balances are considered in the allocation of assets at divorce, so too could personal saving account balances.

5. Individual accounts might end the Social Security Administration's current commitment to disability and survivors insurance.

Comment: Most personal saving account plans assume that the SSA continues to offer a program of disability and survivor benefits. Alternatively, privately managed disability and life insurance plans could be included in the reform plan.

Issues in the Decumulation Phase

During the *decumulation* or retirement phase, concerns are sometimes expressed regarding the following:

1. Some workers may want to retire early, even if their individual account balance is too small to produce a minimally adequate benefit level.

Comment: Most personal saving account plans preclude access to the accounts until some nationally agreed-on retirement age.

2. Some participants would ask for their benefit as a lump sum, rather than an annuity. This produces adverse selection in the annuity pool, and exposes those taking the lump sum to the risk of running out of money.

Comment: Some personal account proposals require that all or a portion of the account must be annuitized.

3. Insurers selling annuities pay a lower annual benefit to those with longer life expectancies. Since women as a group live longer than do men on average, a woman's annual benefit will be smaller than a man's with the same accumulation amount in the pension.

Comment: Some personal account proposals require insurers to use unisex mortality tables in setting the annuity benefits, at least for the minimum guaranteed benefit.

4. Participants might not elect payout plans from their individual accounts that are inflation protected, exposing retirees to a benefit that fell in real terms.

Comment: With the advent of government-issued inflation-linked bonds, insurers can construct a real annuity that would offer protection against inflation.

Clearly some of the objections enunciated by opponents of a personal saving approach are worthy of attention. On the other hand, as we have shown, responses are available to many of them, and most can be dealt with by careful program design.

MEASURES SUPPORTIVE OF AN INDIVIDUAL ACCOUNT SYSTEM

My earlier discussion emphasized that our current system has many problems, some of which are of particular concern to women. These include the fact that Social Security faces insolvency, benefit rules do not guarantee minimum retirement benefits to all, and many working women face extremely high marginal tax rates under the program. Could a well-designed individual account plan solve these problems? I believe so, and I will offer suggestions as to how an individual account plan could be beneficial in an overhauled retirement income system.

In undertaking such an overhaul, I believe that two assumptions are likely to guide policy. First, any reform of the US old-age system - including one with a personal retirement account plan - will have a minimum retirement income promise, payable to retirees whose benefits fall below some poverty threshold. Second, any reformed old-age system in the US will provide some protection against the risks of disability and premature death.

Individual Accounts In a Reformed Old-Age System

My point is that personal account plans cannot be assessed in a vacuum. Rather, if carefully fashioned, they could be a useful element of a reformed retirement income system, one that would benefit women as well as men. Several positive outcomes could result:

- Instituting individual accounts with earnings sharing between spouses would protect retirement accumulations for couples who divorce prior to the current system's 10-year cutoff, helping homemakers and low-earners.
- Instituting funded accounts could afford participants access to capital markets that they previously lacked, potentially increasing many Americans' wellbeing and incentives to learn about financial matters.
- Careful structuring of investment options, along with transparent reporting and disclosure of administrative expenses, would improve investment performance and put competitive pressure on investment managers.
- Low-wage workers' individual account contributions could be boosted with a government match, perhaps at a rate that falls with income. This match would help build up small accounts quickly and also would diminish concerns about administrative expenses on small accounts.
- Retirees could be required to take at least one portion of the benefits as an inflation-indexed annuity priced with unisex mortality tables. This would protect both the plan participant against running out of money, and future taxpayers against the chance that some retirees would later demand that benefits be paid to those who had take a lump sum and lost it.
- Individual accounts could permit future Social Security benefit and tax schedules to be brought into alignment, thus reducing uncertainty regarding future benefit and tax rules for the retirement system.

To the extent that some women - and indeed some men - will still reach retirement age with low benefits, it must be anticipated that our old-age system will still be asked to provide indigent people a minimum level of support. Regrettably, many Social Security reformers have avoided the question of how a safety net would work in a revamped system. Time constraints prohibited the Technical Panel and the Advisory Council from taking a hard look at how old-age benefits, SSI, and DI interact. What is needed is a thorough and integrated analysis of these closely allied programs, and I hope that your Committee can press for this in moving forward on Social Security reform plans. The Health and

Retirement Study is an excellent datasource that could and should be used to address these issues, and I commend the Congress and the National Institute on Aging for its support of this valuable data collection endeavor. Yet many reformers are reluctant to address the key role of a guaranteed minimum benefit under the nation's old-age system, perhaps because doing so spotlights some of the failings of the current program.

One place to begin would be to take a hard look at how well - or how poorly - the safety net is working for older people today. Having assessed this, it would then be necessary to determine what would happen under any particular reform of just the retirement benefit piece, and how the moving parts would mesh. To their credit, personal saving account advocates on the last Advisory Council built a minimum benefit into their individual account approach. In so doing, they show that it is possible to balance an earnings-replacement approach with the redistributive considerations so important to our retirement income system.

Conclusion

In closing, I commend this Committee on its effort to explore how women would fare under alternative Social Security reform plans. We must acknowledge that women, like men, have varied work and marital patterns, and today's patterns differ dramatically from those of 60 years ago. These changes - and ones we will see in the future - must be met by a flexibly adapting retirement income system. Individual saving accounts can help meet the challenges of the new millenium.

Mr. Chairman, this concludes my prepared statement. At this time I will be happy to answer any questions you or the other Committee Members may have.