SEN. JACK REED'S FLOOR STATEMENT
ON PROGRESSIVE PRICE INDEXING 06-29-05

Mr. President, I rise today to express my deep concern about the President's proposal to peg initial Social Security benefits to the growth in prices rather than wages, and the negative impact that his so-called "progressive" price indexing scheme would have on future retirees.

The current method of calculating retirees' initial Social Security benefits was first put in place in 1979, and since then the initial benefit level has risen with the growth in wages, ensuring that benefits reflect increases in living standards over time. Wages tend to grow faster than prices, so the effect of the President's proposed change would be a substantial reduction over time in initial benefit levels for people making more than $20,000 per year.

Two recent reports by the Democratic Staff of the Joint Economic Committee illustrate the extent of the benefit cuts that future retirees would face under the President's proposal.

The first report, *What if President Bush's Plan for Cuts in Social Security Benefits Were Already in Place?*, finds that if a price indexing approach like President Bush's had gone into effect in 1979 instead of the current method, middle-class workers retiring this year would receive a benefit 9 percent smaller than they will get under current law.

CHART 1: The benefit of middle earners retiring at age 65 today would be <u>$1,400 less per year than under current law</u>. A middle earner makes about $37,000 in 2005. These benefit cuts would grow larger over time. For today's 25-year-olds, the benefits for an middle earner would be 26 percent lower or $5,100 per year less when they retire.

CHART 2: Over time, as the benefit cuts grow larger, Social Security would replace a smaller and smaller share of pre-retirement earnings. The replacement rate for today's middle earner aged 65 is 46 percent under current law. Because of already-enacted changes in the retirement age, the replacement rate for today's 25-year-olds who retires at age 65 is scheduled to decrease to 42 percent under current law. If the President's plan were already in effect, when today's 25-year-olds retire, the replacement rate of a middle earner would be less than one-third (31 percent) of pre-retirement earnings.

CHART 3: Price indexing would also hit middle-income workers much harder than upper-income workers, because middle-income workers rely on Social Security for a much larger percentage of their retirement income than do upper-income workers. While the highest earners retiring in 2045 would experience a larger benefit cut than middle earners (46 percent compared with 26 percent), their total retirement income would fall by less (10 percent compared with 17 percent).

Under the President's proposal, Social Security benefit cuts get progressively worse for middle-income workers and Social Security would replace an ever smaller share of workers' pre-retirement earnings. This is probably not the kind of progressivity that most Americans have in mind for Social Security.

The second report, *How President Bush's Social Security Proposals Would Affect Late Baby Boomers*, shows that the President's proposals for price indexing and the privatization tax accompanying private accounts would hit 40- to 50-year-olds particularly hard.

The President has said his proposals for overhauling Social Security would not affect those 55 and older because they are too close to retirement. So there are a lot of 40- to 50-year-olds – the so-called "late baby boomers" – who are wondering what's going to happen to their retirement security. Unfortunately, we don't have good news for them.

CHART 4 (comparing 1st bar w/ 2nd bar): For today's 40-year-old middle-class worker, price indexing starting in 2012 would reduce benefits at age 65 by 9 percent (from $17,000 to $15,450). <u>That's a cut of more than $1,500.</u>

CHART 4 (comparing 2nd bar w/ 3rd bar): Workers with a private account would see a further cut in guaranteed Social Security benefits. Assuming the maximum contribution of up to 4 percent of earnings starting in 2009, today's middle-class 40-year-old workers would see an additional cut of 19 percent (from $15,450 to $12,470) in their guaranteed benefits because of the privatization tax.

CHART 4 (3rd bar): The guaranteed Social Security benefits after both price indexing and the additional privatization tax for those who invest in private accounts would be 27 percent less than under current law for today's 40-year-old worker making about $37,000. The cuts would be larger for higher earners.

If workers simply invested their private account in safe Treasury securities, they would actually be worse off with a private account than without one. The return on their private account after administrative expenses would not be enough to offset the privatization tax.

In order to try for a higher return on their private account, people would have to make riskier investments. But an analysis by Congressional Budget Office economists cited in the JEC report suggests that over the short investment horizon available to 40-to-50-year-olds, they would have a good chance of ending up worse off than if they did not invest in a private account.

When we look at these benefit cuts in the context of what is happening to private pension coverage, we see that the retirement income of the late baby boomers would be even more at risk under the President's proposals

CHART 5: In the past 25 years, there has been a major shift away from traditional defined benefit plans to defined contribution plans. As you can see, the late baby boomers are already assuming more of the risks of investing their own retirement assets than older generations did. Most baby boomers with pension coverage participate in defined contribution plans, so the amount of income that workers can expect from these plans is highly uncertain.

Considering the benefit cuts from price indexing, the greater probability of losing money in a private account over a shorter investment horizon, and the additional tax on benefits for those who invest in private accounts, it's hard to see how today's 40- to 50-year-olds would come out ahead. Clearly, the President's proposals would seriously undermine the retirement security for these late baby boomers.

Furthermore, the President's price indexing proposal does not even close the 75-year gap between promised Social Security benefits and the taxes expected to be paid into the system – it falls short by about 25 percent. Adding on private accounts would worsen Social Security solvency and increase federal debt enormously. If price-indexed benefit cuts were combined with private accounts, future generations would face the double burden of large cuts in their guaranteed Social Security benefits and paying down the higher federal debt.

I want to work with President Bush to promote personal wealth and saving through investment, but let's take the time to find a sensible plan to restore Social Security's solvency first. I urge the President to take private accounts off the table so that we might achieve bipartisan agreement to strengthen Social Security for the long-term.

Finally, it seems to me that the pension crisis in this country is a much more pressing matter that deserves our immediate attention. As the list of under-funded pensions and companies defaulting on pension promises grows, the private pension system is becoming more unstable by the day. Social Security does face long-term challenges, but at the moment it's looking like the strongest leg of our retirement system.

Mr. President, I yield the floor.