REVAMPING SOCIAL SECURITY: SETTING THE STAGE FOR DISCUSSION

When the Depression of the 1930s made it impossible for states, local communities and charitable organizations to protect the welfare of Americans, Franklin D. Roosevelt proposed federal legislation to provide economic assistance in the form of the Social Security Act of 1935 (SSA). The Social Security Act provided for two social insurance programs: one to protect seniors, and another to protect the unemployed.

At the time the Social Security Act became law, there were sixteen workers for every one retiree. Today that ratio is approximately 3:1. Three factors—low birth rates, longer life-spans and the imminent retirement of the baby boomers—are contributing to a future in which the pay-as-you-go system won't be sufficient to meet the needs of beneficiaries.

In order to prevent the bankruptcy of the Social Security program, President Bush has established the President's Commission to Strengthen Social Security. Like the Committee on Economic Security that helped Franklin D. Roosevelt develop the original legislation, the Commission acts as the President's "think tank" on Social Security. Many options are under consideration. These include:

- Raising payroll taxes (at present, workers pay 6.2 percent of their wages into Social Security, and employers match it)
- Raising the cap on taxable income (from $90,000)
- Raising the age of eligibility for full retirement benefits (from 65 to 67)
- Limiting benefits to wealthy retirees
- Calculating benefits according to average living-costs, rather than the Consumer Price Index
- Allowing workers to invest a portion of taxable earnings through private retirement accounts

The last option, misleadingly dubbed the privatization of Social Security (investment of taxable income would be subject to governmental regulation), is likely to become the foundation of the Bush plan; such an ambitious change to the most popular social program in American history has brought the President's proposal under the lens of intense public scrutiny.

FREQUENTLY ASKED QUESTIONS ABOUT SOCIAL SECURITY

Q: Is Social Security a retirement plan?

A: Social Security is not a retirement plan. The program is an insurance plan designed to provide for the basic needs of people who are unable to provide for themselves, such as seniors, widows, disabled persons and dependent children. As it applies to retirees, Social Security is designed to supplement retirement income from pensions, savings, and investments in capital markets.

Q: Where does the money for Social Security come from?

A: Social Security revenue is drawn almost exclusively from taxes on earnings (the 6.2 percent of wages up to $90,000 that employers are required to match). Revenue is credited to two trust funds, the Old-Age and Survivors Insurance and Disability Insurance programs. While there is presently a surplus of funds kept in trust (workers pay more into the system than beneficiaries receive), the surplus is projected to shrink rapidly beginning no later than 2018, at which point the Social Security Administration will pay out more than it receives through payroll taxes.

Q: How are benefits for retirees calculated?

A: To calculate benefits, the Social Security Administration averages a worker's earnings over the 35-year period during which earnings were highest; the number derived is called average indexed monthly earnings, or AIME. Next, the worker's AIME is input into a formula that calculates the monthly payment he or she is eligible to receive each month; that payment is called the primary insurance amount, or PIA, and the formula is as follows:

PIA = (90% of the first $561 of the AIME) + (32% of the AIME between $561 and $3,381) + (15% of the AIME over $3,381)

Under the formula, a 62-year-old worker with average earnings throughout his or her lifetime who retires with eligibility for full benefits (at age 65 or older) will receive approximately $1,150 each month.

THE ARGUMENT AGAINST THE PRESIDENT'S SOCIAL SECURITY PLAN

The stakes are too high to take the unprecedented risk of privately owned retirement accounts.

The same White House that touts Social Security as "one of the great moral successes of the 20th century," is the White House that would risk crippling its essential function: to insure basic needs for American workers and those unable to provide for themselves, a function the program has fulfilled since it began in 1935. The Social Security Administration reports that it paid benefits to more than 50 million people in 2003, providing 66 percent of seniors over half their income. In addition to the aged, the program protects women (57 percent of adult beneficiaries), children (97 percent are eligible for benefits if a working parent dies) and citizens with disabilities (82 percent of Supplemental Security Income beneficiaries are blind or disabled).

Forty-five million people received benefits in 2001, including 28 million retirees, 5 million disabled workers, and 12 million family members of retirees, disabled workers or deceased workers (Congressional Budget Office). High stakes demand that Social Security reform be guided by caution, because too many lives hang in the balance to take unprecedented risks.

The Social Security program is not in such dire straits as the President would have you believe.

According the 64th annual report of the Social Security Administration's Board of Trustees, trust fund reserves are not projected to run out until 2042, at which point the system would still be able to provide as much as 70 percent of scheduled benefits using annual payroll taxes alone (Greenstein, Center on Budget and Policy Priorities, 2004). While long-term insolvency must be prevented, no danger to the program is so immediate that it requires the abandonment of traditional Social Security in favor of an untested system dependent on private investment. The Social Security Administration takes the position that "[there] are no credible plans to replace Social Security as the foundation for the retirement of American workers."

The Bush plan would cut monthly payments to beneficiaries.

Social Security benefits are calculated using a formula that determines a worker's monthly payment by averaging their earnings over the 35-year period during which they earned the most (see "Revamping Social Security: Setting the Stage for Discussion"), and adjusting that number up in relation to living standards at the time of retirement; the adjustment is based on growth of wages over the 35-year period. The Bush plan would base the adjustment on the rise of consumer prices instead, which grow at a much slower rate than wages; the result would be lower monthly payments to beneficiaries. The Washington Post reports that the Chief Actuary of the Social Security Administration estimates that middle-class retirees in 2022 would see benefit cuts of 9.9 percent; middle- and high- income workers would see cuts of 25 percent by 2042, and by 2075, benefits would be cut by 56 percent. The President and his Commission on Strengthening Social Security hope that returns from personal retirement accounts can compensate for benefit cuts. But if privatization fails, reduced Social Security payments won't be enough to provide for the basic needs of beneficiaries.

Massive transition costs would offset any benefits people might get from private retirement accounts.

Any time a program is restructured or replaced, a transition must take place that includes conceptual planning, implementation and adjustment. For a program as massive and bureaucratized as Social Security, the costs involved in such restructuring, called transition costs, are sure to become staggering. Even the most conservative estimates—Vice President Cheney's, for example—place the initial cost of transition to the Bush plan at $750 million (Democratic National Committee, 2005). Time reports that the plan could cost trillions of dollars in the first decades alone, which may help to explain why prominent Republicans, including House Ways and Means Committee Chairman Bill Thomas, have openly opposed it.

The money to cover transition costs would have to come from somewhere, which means that the government would likely have to borrow from the United States Treasury—thereby increasing the national debt. According to National Committee to Preserve Social Security and Medicare (NCPSSM) CEO Barbara Kennelly, "The amount of additional national debt [transition costs] would generate could eat into any returns people might actually get from a private account system."

The President's proposed "flexible retirement plans" are not truly flexible at all.

Under the Bush plan, workers will only be free to choose from among five funds, all of which will be subject to federal regulation. In light of the numerous investment opportunities available in domestic and international stock and bond markets, the five-fund "option" is revealed as a limitation set forth by the White House to minimize administration and management costs (AARP, 2005).

IRAs, 401 (k) plans and private pensions already guarantee workers control over their retirement savings. Social Security is not a default retirement plan, but rather a basic-needs allowance meant to supplement the time-tested plans retirees should depend on.

The Bush plan for Social Security offers little opportunity for workers to leave significant assets to heirs.

The White House has suggested that a worker will be able to leave a "nest egg" to be inherited by survivors in the event of his or her untimely death. In actuality, the Bush plan will require all workers to purchase an annuity (lifetime stream of payments) upon retirement to ensure that Social Security payments and monthly annuity payments provide at least a poverty-level income (Time, 2005). Assets that remain in savings after the purchase of the annuity can be left to survivors, but the bulk of savings may be required to compensate for the cuts in benefits proposed under the Bush plan (National Committee to Preserve Social Security and Medicare, 2005).

Reliance on privately owned retirement accounts puts retirees at risk of financial insecurity.

Payroll tax revenues for Social Security are invested in interest-earning United States Treasury bonds. Treasury bonds earn approximately 6 percent combined interest annually, which has made them "one of the safest investments in the world" for over 2 centuries (AARP, 2005). While investment in capital markets can yield substantial returns, the danger of detrimental losses due to poor investment choices or unforeseen market shifts makes investment in Treasury bonds a wiser choice for retirees. And unlike Social Security benefits, private accounts are not adjusted up in relation to growth in wages or rising inflation, which means that future living expenses could sap the private savings of millions of retirees who would otherwise receive normal Social Security payments.

Dependence on investment through private accounts would significantly increase public debt.

Under the Bush plan, the portion of taxable earnings that a worker invests through private savings accounts would be repaid at retirement through deductions to his or her Social Security benefits—i.e., the worker would owe a debt to the federal government that would be repaid incrementally upon retirement. The Brookings Institution calculates that outstanding public debt would increase to $1 trillion "during the first decade [the accounts] were in effect and by more than $3.5 trillion during their second decade." To make matters worse, the increase in public debt would become permanent, because there would always be outstanding debts, even if all were eventually repaid; ultimately, public debt would exceed 30 percent of GDP under the Bush plan for Social Security (Brookings Institution, 2005).

The poorest Americans would suffer under the President's plan for Social Security.

At least 60 million Americans between ages 25 and 64 earn less than $25,000 annually, and most have no retirement plan to bolster returns from Social Security (Washington Post, 2005). If markets fell substantially, the poorest Americans, who tend to rely exclusively on retirement income from Social Security, would suffer disproportionately under the Bush plan than the higher earners who have retirement savings. By continuing to invest in Treasury bonds, which never lose value due to stock market fluctuations, Social Security can protect those who stand to benefit most from basic-needs assistance.

Reliance on privately owned retirement accounts would put women at risk of financial insecurity.

Social Security benefits are adjusted to reflect changing costs-of-living and are paid out to retirees for the duration of their lives, an example of how the program succeeds as a safety net for seniors; contrastingly, the private accounts proposed by the President would hold a fixed amount, a limitation that puts women at particular risk. House Democratic Leader Nancy Pelosi's (D-CA) office reports that because the life expectancy of women at the age of retirement is 3 years longer than that of men, any contributions women make to private retirement accounts under the Bush plan will have to last longer than contributions made by men—a difficult feat in light of the fact that on average, women earn 27 percent less than men and spend less time in the workforce.

The massive debt caused by transition costs from Social Security to privatized retirement plans may leave lawmakers no choice but to cut other federal programs.

The President has proposed to leave the present system intact for persons 55 and older. But because young workers will be able to divert such a large portion of taxable income into private accounts—4 percent, leaving only 2.2 percent for the Social Security trust—the government may be forced to pay transition costs with a loan from the general fund of the Treasury, which would increase the federal deficit and the national burden of debt. Such an outcome could "[force] policymakers to consider cuts in all federal programs, including Social Security (National Committee to Preserve Social Security and Medicare, 2005)."

THE ARGUMENT FOR
THE PRESIDENT'S SOCIAL SECURITY PLAN

The Social Security program is in crisis.

The Social Security Administration predicts that the narrowing worker-beneficiary ratio (down from 16:1 in the 1930s to 3:1 in 2005) represents "a massive and growing shortfall" in cash flow that will reach $3.7 trillion by 2078. The Administration anticipates that if the program is not changed, one of three consequences must take place: (1) payroll taxes must be increased, (2) future benefits must be cut, or (3) the program must take "massive transfers" from the general revenue. Increasing payroll taxes will decrease consumer spending power and slow economic growth. Cutting future benefits means that workers who support Social Security today may not have their basic needs met when they reach retirement age. If substantial transfers from the general revenue are required to sustain Social Security, programs such as Medicare could lose funding

The President is seeking a bipartisan solution.

The Social Security Advisory Board, self-described as "an independent, bipartisan board created by Congress and appointed by the President" to counsel Washington on Social Security, warns that "[as] time goes by, the size of the Social Security problem grows, and the choices available to fix it become more limited." In response to the need for action, the President has established his Commission on Strengthening Social Security. According to its 2001 charter, the Commission functions to provide "bipartisan recommendations to the President for modernizing and restoring fiscal soundness to the Social Security System." The recommendations are guided by commitments that include (1) keeping benefits intact for retirees and near-retirees, (2) keeping the Social Security surplus dedicated solely to Social Security, (3) keeping payroll taxes at present levels, and (4) allowing individual retirement accounts to "augment the Social Security safety net."

The President proposes a flexible Social Security plan that gives workers investment options.

Rather than mandating that 6.2 percent of social security taxes be invested in United States Treasury bonds—thereby making the statement that Americans can't be trusted with their money—President Bush has proposed to offer the voluntary option of "five broad, general funds: a large-cap stock fund, a small-cap stock fund, an international stock fund, a corporate-bond fund and a Treasury-bond fund (Time, 2005). These funds are sufficiently diversified to guard against detrimental losses, which make them ideal for retirees.

Individually owned retirement accounts will give retirees higher monthly payments than traditional Social Security.

Workers who invest in stock and bond markets can see returns at retirement that exceed the amount they are eligible to receive in Social Security payments. Research presented by the Cato Institute compared returns from Social

Security with returns from capital markets for workers born in 1930, 1950 and 1970. The highest earners born in 1930 are eligible to receive monthly Social Security payments of $1,200 at most. Had their taxable earnings been invested in corporate and government bonds over the same period, monthly returns could have reached $2,072; had the money been invested in stocks, returns could have reached $3,999. Findings for all three cohorts were poignantly similar: "In every case but one, Social Security's benefits are below those earned in capital markets."

Privately owned retirement accounts give workers control over their retirement savings.

Social Security does not include a retirement plan; dollars paid into the system are not earmarked for the individual workers who earned them. As explained by the Congressional Budget Office (CBO), "the worker's eligibility for benefits and the amount that he or she will receive are determined by Social Security rules set in law." In other words, legislation could free the government to divert payroll tax revenues from Social Security into other programs, which is exactly the sort of redistribution the government practices to achieve a balanced budget (e.g., when there is a budget shortfall, it is not unusual for Congress to "raid" the Social Security trust fund to make up for that shortfall). The President's plan allows workers to invest a portion of their taxable earnings privately, because the government is prohibited from "raiding" private assets.

Privately owned retirement accounts will help workers better provide for their families.

What happens to a worker's investment in Social Security in the event of his or her untimely death? The Heritage Foundation reports that "payroll taxes that workers who die young have paid are used to pay benefits to wealthier families who tend to live longer than average." Under the plan proposed by President Bush, privately invested savings from taxable income can be left to a worker's family in the event of his or her untimely death; the amount available will be directly proportional to the amount that the worker has paid into the system.

Privately owned retirement accounts will provide better returns for low-income workers.

Rates of return for low-income workers are low in comparison to higher-income workers—in fact, many low-income males will receive less in benefits that they paid into the Social Security program due to inflation and increased living costs. The Heritage Foundation calculates that "[a] 25-year-old [low-income worker] would have a –4.46 percent rate of return on his Social Security taxes." By allowing individuals to invest a portion of their earnings through private accounts, the President's plan would enable low-income workers to receive higher returns upon retirement.

The President's plan will not raise payroll taxes.

The Brookings Institution has proposed to increase Social Security's 6.2 percent payroll tax by 3-4 percent as a way to offset the looming shortfall in the Social Security program (Fortune, 2005). Though the Democrats have yet to draft new legislation on Social Security, liberal academia has already warmly welcomed the idea of an increased payroll tax. Fortune reports that "higher payroll taxes would cut take-home pay and kill jobs by raising the cost of hiring workers. As a result, they'd make it far harder for Americans to bank their own retirement savings." Fortunately, the position of the White House is that the President will consider "any good idea that does not include raising payroll taxes."

The President's plan will not cut payments to beneficiaries and pre-retirees.

Social Security has always taken in more revenue than it's paid out in benefits, which has resulted in a surplus that topped $1.5 trillion in 2004. The surplus is invested in Treasury bonds that earn $80 billion in annual interest (Social Security Administration, 2004). By progressively reducing payroll taxes, the Social Security surplus can be used to compensate for reduced annual revenues while current beneficiaries and retired baby boomers receive regularly scheduled payments for the duration of their lives—i.e., the program can be phased out without putting retirees at risk.

Alternative Social Security plans threaten the national economy.

The American Association of Retired Persons (AARP), the most powerful senior lobby in the United States, has proposed Social Security reforms that include a payroll tax increase on workers over age 50. Raising taxes by more than $500 billion over a 9-year period will slow the growth of the GDP by more than $38 billion annually and reduce total employment by more than 460,000 jobs annually (Hederman, R. & Foertsch, T., 2005).

A second alternative, proposed by Rep. David Obey (D-Wisconsin), requires a 5 percent increase "on the portion of earnings subject to payroll tax," and a new tax on estates exceeding $3.5 million (Brookings Institution, 2005). Both alternatives ignore the fact that the President's plan will not alter Social Security for workers or beneficiaries over age 55; the surplus of Social Security revenue, combined with revenue from payroll taxes, will be sufficient to provide scheduled payments for today's beneficiaries in addition to the baby boomers who will soon be eligible for full retirement benefits. Both alternatives also include a tax increase, which will decrease consumer spending-power and result in a more sluggish economy.

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