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Social Security: Report of the President's Commission to Strengthen Social Security

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Summary

In May 2001, President Bush signed Executive Order 13210 establishing the *President's Commission to Strengthen Social Security*. The 16-member commission appointed by the President was directed to make recommendations on ways to "modernize and restore fiscal soundness to the Social Security system" in accordance with six guiding principles, one of which mandates the creation of personal retirement accounts. On December 21, 2001, the Commission issued a final report that includes three alternative plans for reforming Social Security. Under all three plans, workers could choose to invest in personal retirement accounts, and their traditional Social Security benefit would be reduced by some amount. The first plan would make no other changes to the program. The second plan would slow the growth of Social Security through one major provision that would index initial benefits to prices rather than wages. The third plan would slow future program growth through a variety of measures. To mitigate the effects of benefit reductions, the latter two plans would guarantee a minimum benefit and enhance benefits for widow(er)s. This report describes the Commission's three reform plans. It will be not be updated.

Background

To a large degree, interest in Social Security reform is driven by the system's projected long-range financing problems attributable primarily to demographic factors. While the more immediate concern is the impending retirement of the baby boom generation (persons born between 1946 and 1964), other factors such as projected increases in life expectancy and declining birth rates contribute to longer-lasting imbalances in the system. Under the intermediate forecast (or "best estimate") of the Social Security Board of Trustees, the Social Security trust funds will be depleted by 2038, at which point annual tax revenue (payroll taxes plus the income tax on benefits) would cover only about 73% of benefit payments (and even less in later years). Over the next 75 years, on average, trust fund expenditures are projected to exceed income by 14%.

To many observers, the crucial date in Social Security financing is not 2038 (when the trust funds are projected to be depleted), but 2016, when outgo is first projected to exceed *tax revenue* (i.e., the system is projected to run a cash flow deficit). Under current assumptions, cash flow deficits would begin in 2016 and continue for the remainder of the projection period. As a result, money would have to be drawn from the general fund of the Treasury to pay benefits and administrative costs in 2016 and each year thereafter.

Much attention has been focused on Social Security reform in recent years, and policymakers have considered a variety of ways to remedy the program's long-range funding problems. Some support traditional measures, such as an increase in the retirement age or an increase in the payroll tax, that would maintain the existing structure of the program. Others favor a major re-design of the system to incorporate personal retirement accounts as a partial replacement or supplement to traditional benefits. This broad range of options is reflected in the 1997 report of the Social Security Advisory Council. Unable to reach consensus on a single approach, the Council devised three different reform plans with each receiving only partial Council endorsement. The many congressional reform proposals introduced in recent years reflect a similar array of ideas.[1]

During the 2000 presidential campaign, President Bush expressed support for allowing workers to invest part of their payroll taxes in personal retirement accounts. In May 2001, he established the *President's Commission to Strengthen Social Security* (Executive Order 13210). The Commission was made up of eight Republicans and eight Democrats, all of whom had previously expressed public support for personal retirement accounts. The commission appointed by the President was directed to recommend ways to "modernize and restore fiscal soundness to the Social Security system" in accordance with six guiding principles of reform:

- Modernization must not change Social Security benefits for retirees or near-retirees.
- The entire Social Security surplus must be dedicated to Social Security only.
- Social Security payroll taxes must not be increased.
- Government must not invest Social Security funds in the stock market.
- Modernization must preserve Social Security's disability and survivors components.
- Modernization must include individually controlled, voluntary personal retirement accounts, which will augment the Social Security safety net.

Recommendations of the President's Commission

On December 21, 2001, the Commission issued a final report, *Strengthening Social Security and Creating Wealth for All Americans*. The report, unanimously approved by

[1] For more information, see CRS Report 97-81, *Recommendations of the 1994-1996 Advisory Council on Social Security*, by Geoffrey Kollmann; CRS Report RL30138, *Social Security Reform: Bills in the 106th Congress*, by David Koitz and Geoffrey Kollmann; CRS Report RL31086, *Social Security: What Happens to Future Benefit Levels Under Various Reform Options*, by David Koitz, Geoffrey Kollmann and Dawn Nuschler; and CRS Issue Brief IB98048, *Social Security Reform*, by Geoffrey Kollmann and Dawn Nuschler.

the Commission, includes three alternative plans for reforming Social Security. Under all three plans, workers could choose to invest in personal retirement accounts and their eventual Social Security benefit would be reduced (the amount of the benefit offset would vary under the three plans).[2] The first plan would make no other changes to the program. The second plan would slow the growth of Social Security through one major provision that would index initial benefits to prices (rather than wages). The third plan would slow future program growth through a variety of measures. To mitigate the effects of benefit reductions, the latter two plans would guarantee a minimum benefit and enhance benefits for widow(er)s.

Under Plans One and Two, a portion of existing payroll tax contributions would be used to fund the accounts (a "carve-out" funding approach). Under Plan Three, workers could make *additional* payroll tax contributions to fund their accounts (an "add-on" funding approach) and receive matching contributions "carved out" of existing payroll taxes. These additional contributions would be subsidized for lower-wage workers.

According to the Commission's report, Plan One would not restore solvency to the Social Security system. Plans Two and Three are reported to restore system solvency on average over the next 75 years, but cash flow deficits would occur at points during the projection period requiring the use of general revenues to close the system's financing gap. The three reform plans put forth by the Commission are described below.

Plan One

Under Plan One, workers could divert 2% of their payroll taxes to a personal retirement account, and their traditional Social Security benefit would be reduced. The amount of the reduction would be equal to what the personal account would provide had it earned a **3.5%** real rate of return (i.e., for purposes of determining the benefit offset, the account is *assumed* to earn 3.5% in real terms). In practice, the payment a worker would receive from his or her account would depend on the *actual* rate of return. Therefore, if the actual rate of return earned by the account is higher than 3.5%, the worker's combined benefit (traditional Social Security benefit plus personal account) would exceed benefits promised under current law. Conversely, if the actual rate of return is lower than 3.5%, the worker's combined benefit would be lower relative to promised current law benefits. It would make no other changes to the program. According to the Commission's report, Plan One would not restore long-range solvency to the system.

Plan Two

Under Plan Two, workers could divert 4% of their payroll taxes to a personal retirement account up to an annual maximum of $1,000 (the maximum contribution would be indexed to average wage growth), and their traditional Social Security benefit would be reduced. The amount of the reduction would be equal to what the account would provide had it earned a **2%** real rate of return (i.e., for purposes of determining the benefit offset, the account is *assumed* to earn 2% in real terms). The payment a worker would

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[2] For a discussion of policy issues related to the creation of personal retirement accounts under Social Security, see CRS Report RL30571, *Social Security Reform: The Issue of Individual Versus Collective Investment for Retirement*.

receive from his or her account, however, would depend on the *actual* rate of return. If the actual rate of return exceeds the assumed rate, the payment provided by the account would exceed the benefit offset. If the actual rate of return is lower than the assumed rate, the payment provided by the account would be smaller than the benefit offset.

To constrain the future growth in benefits projected under current law, initial benefits would be indexed to prices rather than wages, beginning in 2009. This would produce lower benefits for future retirees (and lower system costs) because wages are projected to grow faster than prices over time. To mitigate the effects of this change, it would provide a minimum benefit and enhance widow(er)s' benefits. Workers who earned the minimum wage for at least 30 years would be guaranteed a benefit equal to 120% of the poverty level. Widow(er)s would receive 75% of the couple's combined pre-death benefit, compared to 50%-67% under current law (i.e., widow(er)s would receive a higher percentage of the couple's combined benefit although those benefits under the plan would be lower relative to promised current law benefits). According to the Commission's report, Plan Two would restore long-range solvency to the Social Security trust funds, although general revenue infusions would be required to keep the trust funds solvent from 2025-2054.

Plan Three

Under Plan Three, workers would be allowed to contribute an *additional* 1% of payroll taxes to a personal retirement account and receive a 2.5% matching contribution (up to $1,000 annually) from their current payroll taxes. Lower-wage workers would receive a partial "rebate"on their additional 1% contribution through a refundable tax credit. Those who choose to participate in personal accounts would have their traditional Social Security benefit reduced. Under this plan, the reduction would be an amount equal to what the account would provide had it earned a **2.5%** real rate of return (i.e., for purposes of determining the benefit offset, the account is *assumed* to earn 2.5% in real terms). The payment a worker would receive from his or her account would depend on the *actual* rate of return. If the actual rate of return exceeds the assumed rate, the payment provided by the account would exceed the offset to traditional Social Security benefits. If the actual rate of return is lower than the assumed rate, the payment provided by the account would be less than the benefit offset.

Plan Three would reduce Social Security benefits for future retirees by slowing the growth in initial benefits to reflect projected increases in life expectancy and reduce benefits for higher-wage workers through other changes in the benefit formula (the third replacement factor in the benefit formula would be lowered gradually from 15% to 10%).[3] As under Plan Two, it would provide a minimum benefit and enhance widow(er)s'

[3] Under the current benefit computation formula, three replacement factors are applied to three brackets of a worker's "average indexed monthly earnings" (AIME) to determine the basic monthly benefit amount. (To get the AIME, a worker's past earnings are indexed to reflect the growth in average wages over time, and an average monthly amount is computed based on the 35 highest years.) The two AIME amounts that separate the three brackets (called "bend points") are indexed to average wage growth. In 2001, the basic benefit formula is: **90%** of the first $561 of AIME; plus **32%** of AIME over $561 through $3,381; plus **15%** of AIME over $3,381. Under Plan Three, the third replacement factor would be lowered gradually from 15% to 10%.

benefits. Workers who earned the minimum wage for at least 30 years would be guaranteed a benefit equal to 100% of the poverty level. Widow(er)s would receive 75% of the couple's combined pre-death benefit compared to 50%-67% under current law (as under Plan Two, widow(er)s would receive a higher percentage of the couple's combined benefit, although those benefits under the plan would be lower than those promised under current law). In addition, the plan would revise actuarial benefit adjustments for early/late retirement. Benefits for workers who retire early (before the "full retirement age" (FRA)) would decrease relative to current law, and benefits for workers who retire after the FRA would increase relative to current law. Finally, the plan calls for new (unspecified) dedicated revenue sources for Social Security. According to the Commission's report, Plan Three would restore long-range solvency to the system, although general revenue infusions would be required to keep the trust funds solvent from 2034-2063 (in addition to the new dedicated revenue source).

General Structure of Personal Retirement Accounts

The Commission makes broad recommendations on how personal retirement accounts should be structured within the Social Security system. The Commission recommends that personal accounts be administered by a government-appointed board, which could be modeled after the Thrift Savings Plan Board (which manages a defined contribution plan for federal workers) or the Federal Reserve Board, and that workers be allowed to transfer their accounts to a private provider once the account reaches a certain value. It further recommends that workers invest in a broadly diversified portfolio of corporate stocks, corporate bonds and government bonds, and that they be allowed to change their investment allocations at most once every 12 months.

The Commission further recommends that workers have access to their accounts only at retirement (pre-retirement access would not be allowed), and that they be required to take account distributions as an annuity (a guaranteed payment for life) or as periodic payments. Lump-sum distributions should be allowed only on the portion of the account that exceeds the level of assets needed to provide retired workers with a combined benefit (traditional Social Security plus personal account) that will keep them out of poverty throughout their lifetime. Married couples who annuitize their account balance(s) should be required to purchase a two-thirds joint and survivor annuity. When one spouse dies, the surviving spouse would receive two-thirds of the couple's combined payment. Upon divorce, account assets attributable to contributions made during the marriage and *earnings* on account balances brought into the marriage should be divided equally (account balances brought into the marriage would not be divided). If a worker dies before retirement, the account could be left to his or her heirs.

Under Plans Two and Three, the Social Security benefit constraints recommended by the Commission would apply across-the-board to retirement, survivors, and disability benefits, regardless of whether an individual chooses to participate in personal retirement accounts. Acknowledging that the disability component of the program warrants more careful deliberation, the Commission recommends that reform of the Social Security disability program be addressed separately.

While urging that action be taken soon to restore the fiscal sustainability of the Social Security program, the Commission recommends that policymakers discuss these issues for at least 1 year before taking legislative action.

Commission Members

Patrick Moynihan (*Democrat*) (Co-Chairman)
Former New York Senator and Chairman of the Senate Finance Committee
Dick Parsons (*Republican*) (Co-Chairman)
Co-Chief Operating Officer of AOL/Time Warner
Leanne Abdnor (*Republican*)
Former Executive Director of the Alliance for Worker Retirement Security
Sam Beard (*Democrat*)
Founder and President of Economic Security 2000
John Cogan (*Republican*)
Former OMB Deputy Director under President Reagan
Robert Deposada (*Republican*)
Executive Director, Hispanic Business Roundtable and President and CEO of ONE Research and Marketing, Inc.
Bill Frenzel (*Republican*)
Former Minnesota Representative
Estelle James (*Democrat*)
Consultant with the World Bank, former World Bank lead economist in Policy Research Department
Robert Johnson (*Democrat*)
CEO of Black Entertainment Television
Gwendolyn King (*Republican*)
Former Commissioner of the Social Security Administration
Olivia Mitchell (*Democrat*)
Professor at Wharton University, former co-chair of the 1994-96 Social Security Advisory Council's technical panel on retirement saving
Gerry Parsky (*Republican*)
Former Assistant Secretary of the Treasury under President Ford
Tim Penny (*Democrat*)
Former Minnesota Congressman
Robert Pozen (*Democrat*)
Fidelity Investments
Thomas Saving (*Republican*)
Texas A&M Director of Private Enterprise Research Center and a Social Security Public Trustee
Fidel Vargas (*Democrat*)
Former mayor of Baldwin Park, California and current Vice President of Reliant Equity Investors

For more information on the *President's Commission to Strengthen Social Security*, including full text of commission reports and meeting transcripts, go to the Commission's web site [http://www.CommToStrengthenSocSec.gov].