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Issue Brief for Congress

Social Security Reform

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Geoffrey Kollmann and Dawn Nuschler
Domestic Social Policy Division

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SUMMARY

Although the Social Security system is now running surpluses of income over outgo, its board of trustees projects that its trust funds would be depleted in 2041 and only 73% of its benefits would be payable then with incoming receipts. The trustees project that on average the system's cost would be 14% higher than its income over the next 75 years; by 2080 it would be 50% higher. The primary reason is demographic: the post-World War II baby boomers will begin retiring in less than a decade and life expectancy is rising. By 2025 the number of people age 65 and older is predicted to grow by 74%. In contrast, the number of workers supporting the system would grow by 14%.

The trustees project that Social Security's surplus of taxes and interest will cause the system's trust funds, comprised exclusively of federal bonds, to grow to a peak of $7.2 trillion in 2026. The system's outgo thereafter would exceed its income and the trust funds would be drawn down until their depletion. However, the trustees project that the system's taxes by themselves would fall below its outgo in 2017. At that point, other federal receipts would be needed to help pay for benefits (by providing cash as the federal bonds held by the trust funds are redeemed). If there are no other surplus governmental receipts, policymakers would have three choices: raise taxes or other income, cut spending, or borrow the money.

This adverse outlook is reflected in public opinion polls showing that fewer than 50% of respondents are confident that Social Security can meet its long-term commitments. There also is a growing perception that Social Security may not be as good a value in the future. These concerns and a belief that the nation must increase its national savings have led to proposals to revamp the system.

Others suggest that the system's problems are not as serious as its critics claim. They argue that it is now running surpluses, that the public still likes it, and that there is risk in some of the new reform ideas. They contend that only modest changes are needed.

Today, the ideas range from restoring solvency with minimal changes to scrapping the system entirely for something modeled after IRAs or 401(k)s. This broad spectrum was clearly reflected in the report of a 1997 Social Security Advisory Council. Three very different plans were presented, none of which received a majority's endorsement. Similar diversity is reflected in the many reform bills introduced in the 105th, 106th, and 107th Congresses. In his last three years in office, former President Clinton also heightened the issue. He proposed using the Social Security portion of the looming budget surpluses to buy down the federal debt and crediting the system with the reductions – what effectively would be general fund infusions to the system.

During the 2000 Presidential campaign, President Bush stated that he favored allowing workers to put some of their Social Security taxes in personal accounts where they could invest in stocks if they so desired. He later appointed a commission to make recommendations to reform Social Security. The commission issued a report on December 21, 2001, which includes three options to reform the program. All options feature individual accounts.

MOST RECENT DEVELOPMENTS

During the Presidential campaign, President Bush stated that he favored allowing workers to put some of their Social Security taxes into personal accounts. In May 2001, he appointed a commission to make recommendations to reform Social Security. The commission issued its report on December 21, 2001, which included three options to reform the program. All three feature individual accounts. On December 13, 2001, Representative Shaw introduced H.R. 3497, which would establish personal accounts, funded in part by general revenues, that would be used to guarantee the payment of future benefits promised under current law. On December 19, 2001, Representative DeMint introduced H.R. 3535, a somewhat similar bill but with personal accounts funded by part of the payroll tax. On March 20, 2002, Representative Matsui introduced H.R. 4022, H.R. 4023, and H.R. 4024, which would enact into law options 1, 2, and 3, respectively, of the President's Commission. On May 21, 2002, Representative Matsui introduced H.R. 4780, a bill to reject proposals that would partially or completely substitute traditional Social Security benefits with personal accounts, and Representative Thurman introduced H.Res. 425, a rule providing for consideration of H.R. 3497 in the House. On June 19, 2002, Representative Thurman filed a petition to discharge H.Res. 425 from the Committee on Rules. The petition requires 218 signatures to bring H.R. 3497 to the House floor for debate.

BACKGROUND AND ANALYSIS

Although Social Security's income is currently exceeding its outgo, its board of trustees (three officers of the President's Cabinet, the Commissioner of Social Security, and two members representing the public) projects that on average over the next 75 years Social Security's outgo will exceed its income by 14% and by 2041 its trust funds would be depleted. At that point, its revenues could pay for only 73% of the costs of the program. The primary reason is demographic: the post-World War II baby boom generation will soon be retiring and increasing life expectancy is creating an older society. By 2025, the number of people age 65 and older is predicted to rise by 74%. In contrast, the ratio of workers whose taxes will finance future benefits is projected to grow by only 14%. As a result, the number of workers supporting each recipient is projected to fall from 3.4 today to 2.3 in 2025.

Social Security revenues are paid into the U.S. Treasury and most of the proceeds are used to pay for benefits. Surplus revenue is invested in federal securities recorded to the Old Age, Survivors, and Disability Insurance (OASDI) trust funds maintained by the Treasury Department (OASDI being the formal title for Social Security). Social Security benefits and other costs are paid out of the Treasury and a corresponding amount of trust fund securities are redeemed. Whenever current Social Security taxes are insufficient to pay benefits, the trust fund's securities are redeemed and Treasury makes up the difference with other receipts.

Currently, Social Security tax revenues exceed what is needed to pay benefits. These surpluses and the interest the government "pays" to the trust funds appear as growing trust fund balances. The trustees project that the balances will grow to $7.2 trillion in 2026, after which the system's outgo would exceed its income and the balances would fall. By 2041, the trust funds would be exhausted and technically insolvent. The point at which Social Security taxes alone (ignoring interest paid to the funds) would fall below the system's outgo is 2017. Since interest paid to the funds is an exchange of credits between Treasury accounts

and not a resource for the government, in 2017 other federal receipts would be needed to help meet the system's costs. At that point, policymakers would have three choices: raise taxes, cut spending, or borrow the needed money. The annual draw from the general fund (in 2002 dollars), is forecast to be $74 billion by 2020, and $278 billion by 2030.

Today, the annual cost of the system, $465 billion, is equal to 10.84% of worker's pay subject to Social Security taxation (referred to as taxable payroll). It is projected to rise slowly over the next decade, reaching 11.04% of payroll by 2010. It would then rise more precipitously to 16.02% in 2025 and 17.77% in 2035, as the baby boomers retire. After that, the system's cost would rise slowly to 20.11% of payroll in 2080. The system's average cost over the entire period would be 15.59% of payroll, or 14% higher than its average income. However, the gap between income and outgo would grow throughout the period and by 2080, income would equal 13.43% of payroll, outgo would equal 20.11% of payroll, and the gap would equal 6.68% of payroll. By 2080, outgo would exceed income by 50%.

This adverse outlook is mirrored in public opinion polls showing that fewer than 50% of respondents express confidence that Social Security can meet its long-term commitments. This skepticism is reinforced by growing perceptions that Social Security may not be as good a value in the future. Until recent years, retirees could expect to receive more in benefits than they paid in Social Security taxes. However, because Social Security tax rates have increased to cover the costs of a maturing "pay-as you-go" system, these ratios have become less favorable. Such concerns and a belief that the nation must increase national savings to meet the needs of an increasingly elderly society have led to a number of reform proposals.

Others suggest that the issues confronting the system are not as serious as sometimes portrayed. They point out that there is no imminent crisis, that the system is now running surpluses and is projected to do so for two decades or more, that the public still likes the program, and that there is considerable risk in some of the new reform ideas. They contend that modest changes could resolve the long-range funding problem.

The Basic Debate

The current problem is not unprecedented. In 1977 and 1983, Congress enacted a variety of measures to address similar financial problems. Among them were constraints on the growth of *initial* benefit levels, a gradual increase from 65 to 67 in Social Security's *full retirement age* (i.e., the age for receipt of full benefits), payroll tax increases, taxation of Social Security benefits of higher-income recipients, and extension of coverage to federal and nonprofit workers. Subsequently, new long-term deficits have been forecast, resulting from changes in actuarial methods and assumptions, and from the passage of time, (during which years of deficits at the end of the 75-year valuation period replace recent years of surpluses).

Many believe that action should be taken soon. This has been the view of the Social Security trustees and other recent panels and commissions that have examined the problem, and was echoed by a wide range of interests groups testifying in hearings during the past two Congresses. One of the difficulties is that there is no sense of "near-term" crisis. In 1977 and 1983, the trust funds' balances were projected to fall to zero in a very short time (within months of the 1983 rescue). Today, the problem is perceived to be as little as 15 or as much as 39 years away. Lacking a "crisis," the pressure to compromise is diffused and the issues

and the divergent views about them have led to a myriad of complex proposals. In 1977 and 1983, the debate was not about fundamental reform; it revolved around how to raise the system's income and constrain its costs. Today, the ideas range from restoring the system's solvency with as few alterations as possible to replacing it entirely with something modeled after IRAs or 401(k)s. This broad spectrum was clearly reflected in the Social Security Advisory Council's report in 1997, which presented three different reform plans, none of which garnered a majority of the Council's 13 members. Similar diversity is reflected in the many Social Security reform bills introduced in the past two Congresses.

The Push for Major Reform. Many advocates of reform see Social Security as an anachronism, built on depression-era concerns about high unemployment and widespread "dependency" among the aged. They see the prospect of reform today as an opportunity to modernize the way society saves for retirement. They cite the vast economic, social, and demographic changes that have transpired over the past 67 years and changes made in other countries that now use market-based personal accounts to strengthen retirement incomes and bolster their economies by spurring savings and investments. They believe government-run, pay-as-you-go systems are unsustainable in aging societies. They prefer a system that lets workers acquire wealth by investing in personal accounts for their retirement, rather than the current system that must impose tax hikes on future workers to meet promised benefits.

They also see it as a way to counter skepticism about the current system by giving workers a greater sense of ownership of their retirement savings. They contend that private investments would yield larger retirement incomes because stocks and bonds have provided higher returns than are projected from the current system. Some feel that personal accounts would correct what they see as Social Security's contradictory mix of insurance and social welfare goals; its benefits are not based strictly on a person's contributions, yet because it is not means-tested, many of its social benefits go to well-to-do recipients. Others argue that creating a system of personal accounts would prevent the government from using surplus Social Security taxes to "mask" government borrowing or other spending.

Others, not necessarily seeking a new system, see enactment of long-range Social Security constraints as one element of curbing federal entitlement spending. The aging of society means that the costs of the entitlement programs that aid the elderly will increase greatly in the future. The costs of the largest entitlement programs, Social Security, Medicare, and Medicaid, are directly linked to an aging population. Proponents of imposing constraints on them fear that, if left unchecked, their costs would place a large strain on the federal treasury far into the future, consuming resources that could be used for other priorities and forcing future generations to bear a much higher tax burden.

Some contend that action is needed now as a matter of *fairness*. They point out that many of today's recipients get back more than they paid in Social Security taxes and far more than the baby boom generation will receive. They argue that to put off making changes is unfair to today's workers, who not only must pay for "transfer" payments that they characterize as "overgenerous" and unrelated to actual need, but also have the prospect that their own benefits will have to be scaled back severely. Others emphasize the trustees' adverse outlook and contend that steps need to be taken today (raising Social Security's full-benefit retirement age, constraining its future benefit growth, cutting COLAs, raising taxes, etc.) so that whatever is done to bring the system into balance can be phased in, giving

workers time to adjust retirement expectations to reflect what these programs will be able to provide. Waiting, they fear, would require abrupt changes in taxes and benefits.

The Arguments for Retaining the Existing System. Those who favor a more restrained approach argue that its problems are resolvable with modest tax and spending changes and that the program's critics are raising the specter that Social Security will "bankrupt the Nation" to undermine public support and to provide an excuse to privatize it. They contend that a system of personal savings accounts would erode the social insurance nature of the current system that favors low-income workers, survivors, and the disabled.

Others are concerned that switching to a new system of personal accounts would pose large transitional problems by requiring today's younger workers to save for their own retirement while paying taxes to cover current retirees' benefits. Some doubt that it would increase national savings, arguing that higher government debt (from the diversion of current payroll taxes to new personal accounts) would offset the increased personal account savings. They also contend that the capital markets' inflow created by the accounts would make the markets difficult to regulate and potentially distort equity valuations. They point out that some of the other countries who have moved to personal accounts did so to create capital markets. Such markets, they argue, are already well developed in the United States.

Some argue that a system of personal accounts would expose participants to excessive market risk for an income source that has become so essential to many of the nation's elderly. They contend that the nation now has a three-tiered retirement system — consisting of Social Security, private pensions, and personal assets — that already has private saving and investment components. They contend that while people may want and be able to undertake some "risk" in the latter two tiers, Social Security — as the tier that provides a basic floor of protection — should be more stable. They further contend that the administrative costs of maintaining personal accounts could be very large and significantly erode their value.

Some say that concerns about growing entitlements are overblown, arguing that as people live longer, they will work longer as labor markets tighten and employers offer inducements for them to remain on the job. Moreover, a more liberal immigration policy could be used as a way to increase the labor force, if desired. They argue that the projected low ratio of workers to dependents is not unprecedented; it existed when the baby boomers were in their youth. They point out that the baby boomers are now in their prime working and saving years and contend that the nation's savings rate will rise as the boomers age.

They also caution that too much is being inferred from polling data, noting that public understanding of Social Security and some of the reform ideas is limited and often wrong. They argue that a major reason confidence is highest among the retired is that they know more about the program. Younger workers, who are more skeptical, receive little information about Social Security unless they request it, which very few do.

The Basic Choices. There are many options. The three alternatives offered by the 1994-96 Social Security Advisory Council show that the range of choices is wide: maintaining the current system as much as possible; reducing its future commitments while mandating that workers save more on their own; and totally restructuring Social Security to incorporate a large personal account component. Although there is a consensus that action

needs to be taken soon, there is uncertainty about what should be done and how quickly a consensus plan can be forged.

Specific Areas of Contention

The System's Financial Outlook. There are conflicting views about the severity of Social Security's looming financial shortfall. Some argue that the problem is more acute than the 14% average deficit indicates. They point out that the system's costs are projected to exceed its receipts by 4.04% of taxable payroll in 2030, a difference of 31%. In 2080, the gap would be 6.68% of taxable payroll, a difference of 50%. Thus, on a pay-as-you-go basis, the system would need a lot more than a 14% change in taxes or expenditures to be able to meet its promises. They contend that thinking the problem is 39 years away (i.e., because the trust funds would not be depleted until 2041) ignores the financial pressure Social Security will exert on the government when its expenditures exceed its taxes beginning in 2017. At that point that the government would have to use other resources to help pay the benefits, resources that would otherwise be used to finance other governmental functions.

Others express concern that the problem is being exaggerated. First, they argue that in contrast to earlier episodes of financial distress, the system has no immediate problem. Surplus tax receipts are projected for 15 years and the trust funds are projected to have a balance for 39 years. They contend that projections 75 years into the future cannot be viewed with any significant degree of confidence and Congress should respond to them cautiously. They argue that even if the projections hold, the average imbalance could be eliminated by raising the tax on employees and employers by less than one percent of pay (if started today). They point out that as a share of GDP, the projections show the system's cost rising from only 4.46% today to 6.64% in 2030. While acknowledging that this would be a notably larger share of GDP, they argue that GDP itself would have risen by 70% in real terms. Moreover, while the ratio of workers to recipients is projected to decline, they contend that employers are likely to respond with inducements for older workers to stay on the job longer. "Transitioning" to retirement already is becoming more prevalent, and older workers are increasingly seeing retirement as something other than an all or nothing decision.

Public Confidence. Repeated polling done in recent years, under the sponsorship of the American Council of Life Insurance, shows a majority of Americans express a lack of confidence in the system. Although skepticism abated following legislation in 1983 shoring up the system, it has risen again with more than half of the public now voicing a lack of confidence. Younger workers are particularly skeptical; nearly two-thirds of those below age 55 voicing little confidence compared to less than one-third of those age 55 and older.

Some observers caution about inferring too much from polling data, noting that public understanding of Social Security is limited and often inaccurate. They argue that a major reason confidence is highest among older persons is that, being more immediately affected, they have learned more about the program. Younger workers receive little information about Social Security unless they request it, which very few do. In 1995, the Social Security Administration began phasing in a system to provide annual statements to workers, which some argue will make workers more aware of their promised benefits and thus more trusting of the system. Others, however, suggest the skepticism is justified by the system's repeated

financial difficulties and its diminished "money's worth" to younger workers. Notably, in recent polls reform of Social Security ranked high as a legislative priority.

Increasing Doubts About Money's Worth. Until recent years, Social Security recipients received more, often far more, than the value of the Social Security taxes they paid. However, because Social Security tax rates have increased over the years and the age for full benefits is scheduled to rise, it is becoming increasingly apparent that Social Security will be less of a good deal for many future recipients. For example, for workers who earned average wages and retired in 1980 at age 65, it took 2.8 years to recover the value of the retirement portion of the combined employee and employer shares of their Social Security taxes plus interest. For their counterparts who retired at age 65 in 2002, it will take 16.9 years. For those retiring in 2020, it will take 20.9 years (based on the trustees' 2002 intermediate forecast.) Some observers feel these discrepancies are grossly inequitable and cite them as evidence that the system needs to be substantially restructured.

Others discount this phenomenon, arguing that Social Security is a *social insurance* program serving social ends that transcend questions of whether some individuals do better than others. For example, the program's anti-poverty features replace a higher proportion of earnings for low-paid workers and provide additional benefits for workers with families. Also, today's workers who will receive less direct value from their taxes than today's retirees, have in large part been relieved from having to support their parents, and the elderly are able to live independently and with dignity. These observers contend that the value of these aspects of the system is not reflected in simple comparisons of taxes and benefits.

"Privatization" Debate. Social Security's financing problems, skepticism about its survival, and a belief that economic growth could be bolstered through increased savings have led to a number of proposals to "privatize" part or all of the system, reviving a philosophical debate that dates back to its creation in 1935. All three alternative plans of the 1996 Advisory Council featured program involvement in the financial markets. The first called upon Congress to consider authorizing investment of part of the Social Security trust funds in equities (on the assumption that stocks would produce a higher return to the system). The second would require workers to contribute an extra 1.6% of their pay to new personal accounts to make up for Social Security benefit cuts it called for to restore the system's long-range solvency. The third would redesign the system by gradually replacing Social Security retirement benefits with flat-rate benefits based on length of service and personal accounts (funded with 5 percentage points of the current Social Security tax rate).

The reform that Chile enacted in 1981, which replaced a troubled pay-as-you-go system with one requiring workers to invest part of their earnings in personal accounts through government-approved pension funds, has been reflected in a number of reform bills introduced in recent Congresses. They would permit or require that workers invest some or all of their Social Security tax into personal accounts. Most call for future Social Security benefits to be reduced or forfeited. Likewise, the three options suggested by President Bush's commission would allow workers to choose to participate in individual accounts and reduces their eventual Social Security benefit by the projected value of the account.

Still another approach is reflected in bills that would require that future budget surpluses be used to finance personal accounts to supplement Social Security benefits for those who pay Social Security taxes. Former President Clinton's January 1999 reform plan would have

allocated a portion of the surpluses to personal accounts supplemented by a worker's own contributions and a government match (scaled to income). Another part of his plan called for the diversion of a portion of budget surpluses or the interest savings resulting therefrom to the Social Security trust funds, some of which would be used to acquire stocks, similar to the approach suggested in the one of the Advisory Council's plans and in some recent bills. Most of these approaches require that a new independent board would invest some of these new funds in stock or corporate bonds and the rest in federal securities.

Many personal accounts proponents see them as a way to reduce future financial demands on government and to reassure workers by giving them a sense of ownership of their retirement savings. Others feel that it would enhance worker's retirement income because stocks and bonds generally have provided higher rates of return than are projected from Social Security. In concert with this, they argue it would increase national savings and promote economic growth. Some feel it would correct what they see as Social Security's contradictory mix of insurance and social welfare goals — that its benefits are not based strictly on the level of a person's contributions, yet many of its social benefits go to well-to-do recipients. Others argue that it would prevent the government from using surplus Social Security revenues to "mask" public borrowing or for other spending or tax cuts. Generally, proponents of personal accounts fear that investing the Social Security trust funds in the markets would concentrate too much economic power in a government-appointed board.

Opponents of personal accounts argue that Social Security's problems can be solved without altering the program's fundamental nature. They fear that replacing Social Security with personal accounts would erode the social insurance aspects of the system that favor low-wage earners, survivors and the disabled. Others are concerned that it would pose large transition problems by requiring today's younger workers to save for their own retirement while simultaneously paying taxes to support current retirees. Some doubt that it would increase national savings, arguing that a higher level of governmental borrowing would offset the increased private savings. They also fear that the investment pool created by the accounts could be difficult to regulate and could distort capital markets and equity valuations. Still others argue that it would expose participants to excessive market risk for something as essential as core retirement benefits and, unlike Social Security, would provide poor protection against inflation. Many prefer "collective" investment of the Social Security trust funds in the markets to potentially bolster their returns and spread the risks of poor performance broadly.

The Retirement Age Issue. Raising the Social Security retirement age is often considered as a way to help restore the system's solvency. Much of the upward trend in its costs stems from rising life expectancy. From 1940, when benefits were first paid, the life expectancy for 65-year-old men and women has risen from 12.7 and 14.7 years to 16.5 and 19.7 years, respectively, and by 2030 it is projected to be 19.0 and 22.2 years, respectively. This trend bolstered arguments for increasing Social Security's full benefit age as a way to achieve savings when the system was facing major financial problems in the early 1980s. Congress boosted the "full benefit" age from 65 to 67 as part of the Social Security Amendments of 1983 (P.L. 98-21). This change is being phased in starting with those born in 1938, with the full 2-year hike affecting those born after 1959. It will not raise the first age of eligibility, now age 62, but the benefit reduction for retiring at 62 will rise from 20% to 30%. Proponents of raising one or both of these ages further see it as reasonable in light of past and projected increased longevity. Opponents say it will penalize workers who

already get a worse deal from Social Security than do current retirees, those who work in arduous occupations, and racial minorities and others who having shorter life expectancies.

Cost-of-Living Adjustments (COLAs). Social Security benefits are adjusted annually to reflect inflation. Social Security accounts for 80% of the federal spending on COLAs. These COLAs are based upon the Bureau of Labor Statistics' (BLS) Consumer Price Index (CPI), which measures price increases for selected goods and services. In recent years the CPI has been criticized for overstating the effects of inflation, primarily because the index's market basket of goods and services was not revised regularly to reflect changes in consumer buying habits or improvements in quality. A BLS analysis in 1993 found that the annual overstatement might be as much as 0.6 percentage points. CBO estimated in 1994 that the overstatement ranged from 0.2 to 0.8 percentage points. A 1996 panel that studied the issue for the Senate Finance Committee argued that it might be 1.1 percentage points.

In response to its own analysis as well as the outside criticisms, the BLS has since made various revisions to the CPI. To some extent, these revisions may account for part of the slower CPI growth seen in recent years. However, calls for adjustments continue. According to SSA's actuaries, a COLA reduction of one percentage point annually would eliminate almost two-thirds of Social Security's long-range deficit. While some view further CPI changes as necessary to help keep Social Security and other entitlement expenditures under control, others contend that such changes are just a backdoor way of cutting benefits. They argue that the market basket of goods and services purchased by the elderly is different from that of the general population around whom the CPI is constructed. It is more heavily weighted with healthcare expenditures, which rise notably faster than the overall CPI, and thus they contend that the cost of living for the elderly is higher than reflected by the CPI.

Social Security and the Budget. By law, Social Security is considered to be "off budget" for many aspects of developing and enforcing annual budget goals. However, it is still a federal program and its income and outgo help to shape the year-to-year financial condition of the government. As a result, policymakers often focus on "unified" or overall budget figures that include Social Security. When President Clinton urged that future unified budget surpluses be reserved until Social Security's problems were resolved, and proposed using a portion of the surpluses to shore up the system, Social Security's budget treatment became a major policy issue. Congressional views about what to do with the surpluses are diverse, ranging from "buying down" publicly-held federal debt to cutting taxes to increasing spending. However, support for setting aside a portion equal to the annual Social Security trust fund surpluses is substantial and has made Social Security reform a place holder in much of the current fiscal policy debate. The 106th Congress passed budget resolutions for FY2000 and FY2001 that incorporated budget totals setting Social Security surpluses aside pending consideration of reform legislation. It went on to consider, but did not pass, additional so-called "lock box" measures intended to create procedural obstacles for bills that would divert these set asides for tax cuts or spending increases. Similar legislation in the 107th Congress, H.R. 2, was recently passed by the House (see CRS Report RS20165).

In 1998 the House Republican leadership attempted to define the use of the budget surpluses with passage of H.R. 4579, which would have created a new Treasury account to which 90% of the next 11 years' projected surpluses would be credited. The underlying principle was that 10% of the budget surpluses be used for tax cuts and the remainder held in abeyance until Social Security reforms were enacted. However, the bill was heavily

opposed by Democratic Members, who argued for holding 100% of the surpluses in abeyance, and the Senate did not take the measure before the 105th Congress adjourned.

Earlier in the 105th Congress, Social Security became an issue in consideration of a constitutional amendment to require a balanced federal budget. The amendment (H.J.Res. 1 and S.J.Res. 1) would have included Social Security in the budget calculations, as did similar measures considered in 1995 and 1996. Opponents of including Social Security argued that it would cause the program's surpluses to be used to cover deficits in the rest of the budget and could lead to future cuts in Social Security benefits. Those who wanted to keep it in the calculations argued that it was not their purpose to cut Social Security, but that the program represented too large a share of federal revenues and expenditures to be ignored and that removing it from the calculations would make the goal of achieving a balanced budget much more difficult. On each occasion, critics of the amendment attempted to remove Social Security from the calculations. While these attempts failed, the balanced budget amendment itself failed each time to get the requisite votes in the Senate.

Reform Initiatives

Although the 1994-96 Social Security Advisory Council could not reach a consensus on a single plan, its 1997 report contained three different approaches to restore the system's solvency. The first (the "maintain benefits" plan) would keep the system's benefit structure essentially intact by increasing revenue (including an eventual rise in the payroll tax) and making minor benefit cuts. Its proponents also suggested that part of the Social Security trust funds be invested in stocks. The second (the "individual account" plan) addressed the problem mostly with benefit reductions, and in addition would require workers to make an extra 1.6% of pay contribution to new personal accounts. The third (the "personal security account" plan) proposed a major redesign of the system that would gradually replace the current earnings-related retirement benefit with a flat-rate benefit based on length of service and establish personal accounts funded by diverting to them 5 percentage points of the current payroll tax. It would cover *transition* costs with an increase in payroll taxes of 1.52% of pay and government borrowing. The conceptual approaches reflected in the Council's plans can be found in many reform bills introduced in recent Congresses.

In his last three years in office, former President Clinton repeatedly called for using Social Security's share of looming budget surpluses to reduce publicly-held federal debt and crediting the trust funds for the reduction. In his 1999 State of the Union message, he proposed crediting $2.8 trillion of some $4.9 trillion in budget surpluses projected for the next 15 years to the trust funds — nearly $.6 trillion was to be invested in stocks, the rest in federal securities. The plan was estimated to keep the system solvent until 2059. Critics raised concerns that it was crediting Social Security's trust funds twice for its surpluses and that the plan would lead to Government ownership of private companies, which they argued ran counter to the nation's free enterprise system. He further proposed that $.5 trillion of the budget surpluses be used to create new Universal Savings Accounts (USAs) — 401(k)-like accounts intended to supplement Social Security. In June 1999, he revised his plan by calling for general fund infusions to the trust funds equal to the interest savings achieved by using Social Security's share of the budget surpluses to reduce federal debt. The infusions were to be invested in stocks until the stock portion of the trust funds' holdings reached 15%. In October 1999, he revised the plan again by dropping the stock investment idea – all the

infusions were to be invested in federal bonds. His last plan, offered in January 2000, was similar but again called for investing up to 15% of the trust funds in stock.

Although the 106th Congress took no action on the issue, a number of Social Security changes were considered. Following a public statement by President Clinton that he would support repeal of the Social Security earnings test, Congress passed and the President signed H.R. 5 (P.L. 106-182), a bill allowing recipients ages 65 to 69 to work without losing benefits effective in 2000. Under the old law, recipients age 65 to 69 who earned more than $17,000 in 2000 would have lost one dollar in benefits for each three dollars they earned above that amount; there was no loss of benefits once a person reached age 70 (see CRS Report 98-789). Congress also considered, but did not pass, legislation to repeal part of the income taxation of Social Security benefits, the part that is credited to the Medicare HI program. Legislation enacted in 1993 had made up to 85% of benefits taxable for some recipients. H.R. 4865, as passed by the House in the 106th Congress, would have repealed that measure, and thereby limited the taxable portion of benefits to 50%. The bill, however, was not taken up by the Senate before it adjourned sine die (see CRS Report RL30581).

Social Security reform became a major issue in the 2000 Presidential race. President George W. Bush favored giving workers the option to put some of their Social Security taxes into personal accounts. Then Vice President Al Gore proposed buying down the debt and crediting the interest savings to Social Security. He also endorsed a different form of personal accounts, but not with Social Security taxes.

Reform Bills in Recent Congresses. A large number of reform bills have been introduced in the past several Congresses. During the 103rd Congress, four bills sought a mix of benefit reductions and tax hikes, including raising the full benefit age to 70, reducing COLAs, and other benefit reductions. In the 104th Congress, three more proposals not only encompassed some of these changes, but also sought to privatize a portion of the program. Major reform proposals burgeoned in the 105th and 106th Congresses. In the 105th Congress, ten bills designed to reform Social Security using personal accounts also were introduced. (For a description of these bills, see CRS Report 98-750, *Social Security Reform: Bills in the 105th Congress and other Proposals.*)

In the 106th Congress, the most numerous Social Security bills introduced would alter the program's budget treatment or create budget "lock boxes," mentioned earlier. More than 40 bills fell into this category. A second group would have addressed the system's problems directly with some combination of benefit restraints and income-producing measures. Many also would have made some use of the nation's financial markets, either by creating new personal savings accounts to supplement or take the place of future Social Security benefits, or by permitting the investment of the trust funds in the markets. Some in this group would have phased-in new personal accounts rapidly, giving workers bonds for their past Social Security taxes, while others envisioned a long transition. Still others did not propose altering the current system but would have created personal accounts to offset constraints that may eventually be needed to restore the system's solvency. (For a description of these bills, see CRS report RL30138, *Social Security Reform: Bills in the 106th Congress.*)

During the 2000 campaign, President Bush stated that he favored allowing workers to put some of their Social Security taxes in personal accounts. In May 2001, he appointed a commission to make recommendations to reform Social Security. As principles for reform,

the President stated that it must preserve the benefits of current retirees and older workers, return Social Security to a firm financial footing, and allow younger workers to invest in personal savings accounts. The commission issued a final report on December 21, 2001, which includes three options to reform the program. Each option allows workers to choose to participate in individual accounts and reduces their eventual Social Security benefit by the projected value of the account. The first option allows workers to divert 2% of their payroll taxes to these accounts, but does not make any other changes. The second allows workers to divert 4% of their payroll taxes, up to an annual maximum of $1,000; cuts future benefits by indexing their growth to prices rather than wages; and increases benefits to low-paid workers and widow(er)s. The third allows workers to contribute an additional 1% of payroll taxes with a government match of 2.5% up to an annual maximum of $1,000; cuts future benefits by indexing their growth to increases in longevity and, for high-paid workers, by modifying the benefit formula; and increases benefits to low-paid workers and widow(er)s.

Legislation in 107th Congress. Representatives Sessions and Shadegg introduced H.R. 849 on March 1, 2001. Under the bill, workers could elect to contribute the equivalent of their share (6.2%) of the Social Security tax to personal accounts. After participating in the personal accounts for 15 years, the full (12.4%) of the Social Security tax would be placed in the personal accounts. Workers who choose to participate would not receive any Social Security benefits.

Representative Petri introduced H.R. 2110 on June 7, 2001. The bill would make no changes to Social Security taxes or benefits, but it would allow workers to elect to contribute up to $10,000 a year to personal Social Security accounts. When the account is opened, an additional $1,000 would be deposited from the general fund of the Treasury. The funds would be administered by an Investment Board and placed in a common stock indexed fund, insurance contracts, certificates of deposit, or other investments as the board may provide. Distributions from the accounts would be in the form of an annuity or under a schedule similar to that applied to Individual Retirement Accounts (IRAs).

Representatives Kolbe and Stenholm introduced H.R. 2771, a modified version of H.R. 1793 in the 106th Congress, on August 2, 2001. For workers under age 55, H.R. 2771 would mandatorily divert three percentage points of the first $10,000 (adjusted thereafter to inflation) of a worker's earnings, and 2 percentage points on earnings above $10,000, of the Social Security tax rate into new personal accounts. Workers would be allowed to make additional contributions of up to $5,000 (adjusted thereafter to inflation), with lower-paid workers eligible to receive additional credit toward their account of up to $600. It would impose benefit formula constraints substantially limiting the future growth of benefits for middle and high-paid workers, and reduce COLAs by 0.33%. It provides a minimum benefit tied to the poverty level. It increases revenue by increasing the maximum taxable wage base and crediting all of the revenue from taxation of Social Security benefits to the Social Security trust funds, instead of part going to Medicare.

Representative Shaw introduced H.R. 3497 on Dec. 13, 2001. The bill would establish a system of voluntary personal accounts equal to between 2% and 3% of pay for workers who pay Social Security taxes. Workers' Social Security taxes would be unaffected, since initially the accounts would be funded with general revenues. The accounts would be managed by selected investment companies through portfolios containing a 60/40% split of equities and corporate bonds. Upon entitlement to Social Security, an amount equal to 95%

of a "life annuity" would be transferred monthly from each worker's account to the Social Security system, and the higher of current law Social Security benefits or the life annuity would be paid to the recipient (in effect, the annuity payment would fund a portion or all of the Social Security benefit). The remaining 5% of the account balance would be paid to the worker as a lump sum. The account balances of deceased recipients would be used to finance Social Security benefits of any eligible survivors or would otherwise revert to the Social Security trust funds. The account balances of workers who die before entitlement with no eligible survivors would become part of the worker's estate. The proposal also would eliminate the Social Security earnings test for all retirees, and enhance benefits for spouses by increasing benefits for divorced spouses, workers who stay home to care for children, and retired or disabled widow(er)s.

Representatives DeMint and Armey introduced H.R. 3535 on Dec. 19, 2001. In some respects it is similar to H.R. 3497. The main difference is that H.R. 3535 would divert from 3% to 8% of payroll taxes to the individual accounts. It also would allow more of the individual account to be paid as a lump sum, and would place 40% of account investments in U.S. government (rather than corporate) bonds. Also, H.R. 3535 does not contain measures to eliminate the Social Security earnings test or enhance benefits for spouses.

Representative Matsui introduced H.R. 4022, H.R. 4023, and H.R. 4024 on Mar. 20, 2002. The bills would enact into law reform models 1, 2, and 3, respectively, of President Bush's Commission to Strengthen Social Security. The stated purpose is to subject the proposals to debate now, rather than waiting until after this year's Congressional elections. On May 21, 2002, Representative Matsui introduced H.R. 4780, a bill to reject proposals that would partially or fully substitute traditional Social Security benefits with personal accounts.

Representative Thurman introduced H.Res. 425 on May 21, 2002. H.Res. 425 is a rule that provides for consideration of H.R. 3497 (Shaw) in the House. It also provides for consideration of H.R. 3535 (DeMint), H.R. 4022 (Matsui), H.R. 4023 (Matsui), H.R. 4024 (Matsui) and H.R. 4780 (Matsui) as amendments in the nature of a substitute to H.R. 3497. The stated intent of the resolution is to bring proposals that would establish personal accounts within the Social Security system to the House floor for debate. On June 19, 2002, Representative Thurman filed a petition to discharge the Committee on Rules from consideration of the resolution. The discharge petition (Petition 107-7) requires 218 signatures to bring the measures specified in the resolution to the House floor for debate. Status information on the petition (including a list of signatories) is available on the Office of the Clerk's Web site at [http://clerk.house.gov/107/lrc/pd/petitions/dispet.htm].

LEGISLATION

H.R. 2 (Herger)
Reserves Social Security and Medicare surpluses for debt reduction until reform is passed. Passed House, February 13, 2001, 407-2.

H.Con.Res. 282 (Shaw)
Expresses the sense of the Congress that Social Security reform legislation should guarantee current-law benefits to current and future retirees, without raising taxes. Passed House, December 12, 2001, 415-5.

H.R. 849 (Sessions)
Provides the opportunity for each American to provide for his or her retirement through personal accounts. Introduced March 1, 2001; referred to Committee on Ways and Means.

H.R. 2110 (Petri)
Provides for the creation of voluntary personal accounts under the Social Security system. Introduced July 7, 2001; referred to Committee on Ways and Means.

H.R. 2771 (Kolbe)
Provides for individual security accounts funded by employee/employer Social Security payroll deductions. Introduced August 2, 2001; referred to Committee on Ways and Means.

H.R. 3497 (Shaw)
Creates personal Social Security accounts ensuring continued payment of full benefits and makes certain benefit improvements. Introduced December 13, 2001; referred to Committee on Ways and Means.

H.R. 3535 (DeMint)
Creates Individual Social Security Accounts ensuring full benefits to all workers and their families. Introduced December 19, 2001; referred to Committee on Ways and Means.

H.R. 4022, H.R. 4023, and H.R. 4024 (Matsui)
Enacts into law reform models 1, 2, and 3, respectively, of President Bush's Commission to Strengthen Social Security. Introduced March 20, 2002; referred to Committee on Ways and Means.

H.R. 4069 (Shaw)
Makes miscellaneous enhancements in Social Security spousal benefits. Passed House, May 14, 2002, 418 -0.

H.R. 4070 (Shaw)
Provides additional safeguards for Social Security and SSI recipients with representative payees and enhances other program protections. Passed House, June 26, 2002, 425-0.

H. R. 4780 (Matsui)
Rejects proposals to substitute traditional Social Security benefits with personal accounts. Introduced May 21, 2002; referred to Committee on Ways and Means.

H.Res. 425 (Thurman)

Provides for consideration of H.R. 3497 in the House. Further provides for the consideration of H.R. 3535, H.R. 4022, H.R. 4023, H.R. 4024 and H.R. 4780 as amendments in the nature of a substitute to H.R. 3497. Introduced May 21, 2002; referred to Committee on Rules. Petition to discharge the Committee on Rules from consideration of H.Res. 425 filed on June 19, 2002 (Petition 107-7).