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Social Security Reform: Individual Account Proposals

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ABSTRACT

A number of measures to reform the Social Security system have proposed that individual accounts be incorporated into a reformed system. Proposals introduced in the 106th and 107th Congresses are compared with respect to the role the accounts would play, whether they would be mandatory or voluntary, the level of contributions, how funds would be managed and invested, whether a minimum benefit is promised, and how the accounts would be treated for income tax purposes. This report will be updated as legislative action occurs.

Social Security Reform: Individual Account Proposals

Summary

Many proposals have been advanced to reform Social Security. Some would establish "Social Security individual accounts" (SSIAs) to accumulate contributions for workers, invest their funds, and provide them with retirement income. Key features of 18 SSIA proposals are compared in this report. The proposals vary in regard to: the basic purpose of the accounts; whether participation is mandatory or voluntary; the source and level of contributions; how account assets are managed; what investment choices are available; whether or not a minimum benefit is promised; and how the federal income tax applies.

Fourteen of the 18 SSIA proposals would use the new accounts to replace a part (in one case all) of Social Security benefits ("carveout" plans). The other four proposals would use SSIAs as a means for workers to supplement Social Security ("add-on" plans). Five of the 14 carveout plans would mandate participation; the other nine propose voluntary carveouts. Two of the four add-on plans would mandate participation. However, three of the seven mandatory plans would limit the mandate to workers under a certain age.

Proposed contributions to SSIAs range from 1% of wages subject to the Social Security payroll tax up to the full 12.4% employee/employer payroll tax. The carveout plans would divert some part (in one case all) of Social Security taxes for contribution to SSIAs. However, eight of the 18 proposals would draw on general federal revenue for some or all of the contributions.

Ten of the 18 SSIA proposals would limit investment options for account assets to a few funds approved expressly for that purpose by a board of trustees. The eight exceptions would allow individuals to invest their SSIA assets with a broader range of existing financial institutions.

Five of the 14 carveout proposals would guarantee participants some minimum SSIA benefit to protect against adverse investment outcomes, the guarantees being based in most cases on an individual's Social Security benefit entitlement. Of the nine carveout proposals offering no guarantee, five do not mandate participation. Two add-on proposals include a benefit floor.

Treatment of SSIAs under the federal income tax would vary, with five of the 18 proposals essentially following current tax policy for private retirement plans. At the other extreme, one plan would make SSIA contributions, investment earnings, and distributions completely tax-exempt.

This report will be updated as legislative action occurs.

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Introduction

Congress has acted many times to promote voluntary individual retirement saving through tax incentives. Landmark legislation includes: authorization of individual retirement accounts (IRAs) for workers with no employer-sponsored pension plan (1974); specification of rules for employer-sponsored salary deferral retirement plans in §401(k) and §457 of the tax code (1978); expansion of IRA eligibility to all workers and their spouses (1981); establishment of Roth IRAs in 1997; and increased contribution limits and more flexible portability rules in 2001.

Beginning with the 106th Congress, serious attention was given to making individual retirement saving an integral part of the mandatory Social Security system. Numerous Social Security reform proposals have been offered in light of actuarial projections that indicate the Social Security trust funds may exhaust their financial reserves during the first half of the 21st century. Concern about this possibility of system insolvency is amplified by the demographic context, namely, the approaching swell in the retirement age population as the large "baby boom" age cohorts begin to reach age 65 in 2011. Some of these reform proposals would make "Social Security individual accounts" (SSIAs) an integral part of a reformed Social Security system. Other proposals would establish SSIAs for the purpose of supplementing the retirement benefits paid by Social Security. In 2001, the President's Commission to Strengthen Social Security recommended that any reform of the system include individual accounts as an element.

The features of SSIA proposals vary widely. This report summarizes 18 proposals that would establish SSIAs. Nine of them were introduced as bills in the 106th Congress, and nine have been introduced in the 107th Congress. (Several bills in the latter group are revisions of bills introduced by the same sponsors in the 106th Congress.) These 18 proposals are as follows:

Introduced in 106th Congress:

H.R. 874 (Porter)–Individual Social Security Retirement Accounts Act
H.R. 3206 (N. Smith)–Social Security Solvency Act
H.R. 4839 (Sanford)–Personal Lockbox Act[1]
H.R. 5659 (Kasich)–Personal Social Security Account Act
S. 21 (Moynihan)–Social Security Solvency Act

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[1] Earlier in the 106th Congress, Representative Sanford introduced three bills (H.R. 249, H.R. 250, H.R. 251) that also would have created SSIAs.

S. 263 (Roth)–Personal Retirement Accounts Act
S. 588 (Bunning)–Social Security for the 21st Century Act
S. 1103 (Grams)–Personal Security and Wealth in Retirement Act
S. 2774 (Gregg)–Bipartisan Social Security Reform Act[2]

Introduced in 107th Congress:

H.R. 849 (Sessions)–Savings Accounts for Every American Act
H.R. 2110 (Petri)–Retirement Security Act
H.R. 2771 (Kolbe/Stenholm)–21st Century Retirement Act
H.R. 3497 (Shaw)–Social Security Guarantee Plus Act
H.R. 3535 (DeMint/Armey)–Social Security Ownership and Guarantee Act
H.R. 4022 (Matsui)–President's Commission Reform Model 1[3]
H.R. 4023 (Matsui)–President's Commission Reform Model 2
H.R. 4024 (Matsui)–President's Commission Reform Model 3
S. 2693 (Dorgan)–Social Security Plus Account Act[4]

Table 1 compares several significant elements of the 18 proposals. (Although some of the Social Security proposals that include SSIAs also call for major changes in Social Security benefits and/or financing, these broader reforms are not discussed here, nor are these features of the proposals shown in **Table 1**. For a general discussion of Social Security reform, see: CRS Issue Brief IB98048, *Social Security Reform*.)

Comparison of SSIA Proposals

Some SSIA proposals are designed to replace a part of Social Security benefits ("carveout" plans), with part of Social Security payroll taxes diverted into the SSIAs. Others would use SSIAs as a means for workers to supplement Social Security ("add-on" plans), either through their own contributions or with federal payments to their accounts. Fourteen of the 18 proposals outlined in **Table 1** are carveout plans.[5] Five of these 14 plans would mandate participation; the other nine propose voluntary

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[2] An earlier version of this bill, S. 1383, was also introduced by Senator Gregg in the 106th Congress.

[3] Representative Matsui's three bills are not detailed proposals. They simply call for implementation of the options set forth in the report of the President's Commission to Strengthen Social Security. These bills were introduced to stimulate a policy debate on SSIAs during the 107th Congress. For more information on the Commission's options, see CRS Report for Congress RS21095, *Social Security: Report of the President's Commission to Strengthen Social Security,* by Dawn Nuschler, December 21, 2001.

[4] This bill advances an approach originally proposed by President Clinton in his FY2000 budget, which advocated Universal Savings Accounts as part of a reform of Social Security.

[5] H.R. 4024 (Commission Reform Model 3) is categorized as a carveout plan in this discussion, but its carveout feature is contingent upon an individual's election to contribute an additional 1% of taxable wages to an account. The discussion of add-on plans refers to those that are purely add-on in nature.

carveouts. Two of the four add-on plans would mandate participation. Of the seven mandatory plans (five carveouts, two add-ons), three would limit the mandate to workers under a certain age.

Contributions would range from 1% of wages subject to the Social Security payroll tax (H.R. 5659) to the full 12.4% employee/employer payroll tax (H.R. 849). Eight proposals (H.R. 2110, H.R. 2771, H.R. 3497, H.R. 4024, H.R. 4839, S. 263, S. 2774, S. 2693) would augment employee contributions with government transfer payments or income tax credits.

Ten of the 18 SSIA proposals would limit the options for investment of contributions to a few funds approved expressly for that purpose by a board of trustees, in a manner similar to the operation of the federal employees' Thrift Savings Plan. The eight exceptions would allow individuals to invest their SSIA assets with a broader range of existing financial institutions that meet certain federal standards. Four of these eight proposals would allow this latter approach only for accounts holding assets in excess of some minimum level.

Five of the 14 carveout proposals would guarantee participants some minimum SSIA benefit to protect against adverse investment outcomes. Guaranteed minimums generally are based on some combination of entitlement under Social Security and/or absolute dollar amounts. However, S. 1103 sets a minimum at 150% of the official poverty income level for a single-person household. Of the nine carveout proposals offering no guarantee, six (H.R. 849, H.R. 4022, H.R. 4023, H.R. 4024, S. 21, S. 588) do not mandate participation, leaving H.R. 250, H.R. 2771, and S. 2774 as the only mandatory carveout plans with no promised SSIA minimum. Two add-on proposals (H.R. 2110, H.R. 3497) would provide a benefit floor – a benefit equal to at least as much as an individual's Social Security benefit under current law.

Treatment of SSIAs under the federal income tax would vary. Five of the 18 proposals essentially follow current tax policy for most private retirement plans; that is, income tax is deferred on contributions and investment earnings and collected when the funds are distributed. Nine proposals would tax all or part of employee contributions, but one of these nine (S. 1103) would exempt investment earnings from taxation. The other eight would apply the tax rules for Social Security benefits to some part of previously untaxed distributions. S. 588 would make contributions, investment earnings, and distributions completely tax-exempt in all circumstances. Tax treatment was not specified in the three options offered by the President's Commission to Strengthen Social Security (H.R. 4022, H.R. 4023, H.R. 4024).

Table 1. Selected Features of Social Security Individual Accounts Included in Social Security Reform Proposals

[NOTE: abbreviations explained at end of table]

Bill no. (sponsor), and short title	SSIA relationship to OASDI	SSIA contribution rate (pct. of wages subject to OASDI tax)	SSIA fund management	SSIA investment choices	SSIA minimum benefit guarantee	Federal income tax treatment of SSIA: Contributions	Investment earnings	Withdrawals
Bills introduced in 106th Congress:								
H.R. 874 (Porter), Individual Social Security Retirement Accounts Act	carveout; participation voluntary	5% employee, 5% employer match; from taxes diverted from OASDI	trusts registered with SSA to administer SSIAs	options offered by SSA-approved trustees	lesser of 95% of PIA or 40% of AIME	employee share taxable; employer match tax-deferred	tax-deferred	tax-deferred amounts taxable, partly on same basis as OASDI benefits
H.R. 3206 (N. Smith), Social Security Solvency Act	carveout; participation voluntary for covered workers under age 65 on 1/1/2001	2.5% from taxes diverted from OASDI, rising to 2.75% for 2026-2038; rate thereafter depends on OASDI funding status	Social Security Board of Trustees	3 indexed funds with varied asset mixes	OASDI benefit less account's standard annuity value	one-half completely tax-deferred, other half deferred up to $2,000	tax-deferred	taxable on same basis as OASDI benefits
H.R. 4839 (Sanford), Personal Lockbox Act	carveout; participation required if born after 1944, but individual contributions up to $10,000 are voluntary	pro-rata share of FICA tax from surplus of OASI receipts less expenditures; limited contribution from federal revenue for low-income individuals	SEC-approved Personal Retirement Account trustees	all financial institutions that pass SEC risk screen	none	voluntary contributions taxable, government contribution not taxed	tax-deferred	for amounts attributable to federal contribution, half not taxed, half taxable on same basis as OASDI benefits; other amounts not taxed

Bill no. (sponsor), and short title	SSIA relationship to OASDI	SSIA contribution rate (pct. of wages subject to OASDI tax)	SSIA fund management	SSIA investment choices	SSIA minimum benefit guarantee	Federal income tax treatment of SSIA: Contributions	Investment earnings	Withdrawals
Bills introduced in 106th Congress (continued):								
H.R. 5659 (Kasich), Personal Social Security Account Act	carveout; participation voluntary for those born after 1944	from 1% to 3.5%, depending on wage level, from taxes diverted from OASDI	Personal Social Security Fund under Board of Trustees	range of funds similar to those of TSP	none	tax-deferred	tax-deferred	taxable
S. 21 (Moynihan), Social Security Solvency Act	carveout; participation voluntary; employee payroll tax cut even if nonparticipant	1% employee, 1% employer match; from taxes diverted from OASDI	Voluntary Investment Fund under SSA, or private IRAs	options offered by approved institutions	none	taxable; employer match tax-deferred	tax-deferred	tax-deferred amounts taxable
S. 263 (Roth), Personal Retirement Accounts Act	add-on; participation required	government puts in $250 + share of budget surplus proportional to employee's payroll tax	Personal Retirement Accounts Board	G,F,C funds like TSP, other funds Board recommends	none	tax-deferred	tax-deferred	taxable
S. 588 (Bunning), Social Security for the 21st Century Act	carveout; participation voluntary	government contributes by diverting taxes from OASDI, rising to 50% of tax after 20 years	Retirement Security Fund Investment Board	options selected by Board	none	tax-exempt	tax-exempt	tax-exempt

Bill no. (sponsor), and short title	SSIA relationship to OASDI	SSIA contribution rate (pct. of wages subject to OASDI tax)	SSIA fund management	SSIA investment choices	SSIA minimum benefit guarantee	Federal income tax treatment of SSIA:		
						Contributions	Investment earnings	Withdrawals
Bills introduced in 106th Congress (continued):								
S. 1103 (Grams), Personal Security and Wealth in Retirement Act	carveout; participation voluntary	5% employee (up to 25% max.), 5% employer match; from taxes diverted from OASDI	Federal Personal Retirement Investment Board	options offered by Board-approved trustees	150% of poverty-level income for single person	employee share taxable; employer match tax-exempt	tax-exempt	tax-exempt
S. 2774 (Gregg), Bipartisan Social Security Reform Act	carveout; participation required	2% from taxes diverted from OASDI; up to $2,000 voluntary, matched by government payments if low income; one-time government payments to Kidsave account if born after 1994	Individual Savings Fund Board under SSA	same options as TSP; Board to recommend other options to Congress	none	tax-deferred	tax-deferred	tax-deferred amounts taxable
Bills introduced in 107th Congress:								
H.R. 849 (Sessions), Savings Account for Every American Act (SAFE)	new accounts offered in lieu of OASDI if held at least 15 years; participation voluntary	6.2% from employee plus 6.2% from employer; no tax paid to OASDI by either employee or employer	SAFE accounts approved by Sec'y of Treasury	options offered by Treasury-approved trustees; life insurance contracts excluded	none	tax-deferred	tax-deferred	taxable before age 59½ unless funds used for certain purposes; tax-free after 59½

Bill no. (sponsor), and short title	SSIA relationship to OASDI	SSIA contribution rate (pct. of wages subject to OASDI tax)	SSIA fund management	SSIA investment choices	SSIA minimum benefit guarantee	Federal income tax treatment of SSIA: Contributions	Investment earnings	Withdrawals
Bills introduced in 107th Congress (continued):								
H.R. 2110 (Petri), Retirement Security Act	add-on; participation required if born after 6/30/2002, but employee/employer contributions are voluntary	$1,000 one-time payment when account is established, from federal revenue from tax on OASDI benefits; up to $10,000 by employee/employer combined	Social Security Investment Trust Fund (under Fed. Ret. Thrift Investment Board)	G,F,C funds like TSP's, other funds Board recommends	OASDI benefit paid to extent it exceeds benefit from Retirement Security Act	up to $5,000 tax-deferred; other contributions taxable	tax-deferred	benefits equivalent to OASDI benefits taxable on same basis as OASDI; other tax-deferred benefits fully taxable
H.R. 2771 (Kolbe/ Stenholm), 21st Century Retirement Act	carveout; participation required; voluntary contributions allowed for OASDI add-ons	3% of 1st $10,000 of wages + 2% of other wages diverted from OASDI; up to $2,000 voluntary, matched by government payments if low income	Individual Security Fund Board under SSA; account can be transferred to private firm when balance reaches $7,500	options selected by Board	none	taxable	tax-deferred	tax-deferred amounts taxable on same basis as OASDI benefits
H.R. 3497 (Shaw), Social Security Guarantee Plus Act	add-on; participation voluntary	2%-3% of pay contributed from government payments	Social Security Guarantee Board under SSA	qualified mutual funds; stock/bond mix of 60/40 generally required	OASDI benefit	tax-deferred	tax-deferred	taxable on same basis as OASDI benefits

Bill no. (sponsor), and short title	SSIA relationship to OASDI	SSIA contribution rate (pct. of wages subject to OASDI tax)	SSIA fund management	SSIA investment choices	SSIA minimum benefit guarantee	Federal income tax treatment of SSIA: Contributions	Investment earnings	Withdrawals
Bills introduced in 107th Congress (continued):								
H.R. 3535 (DeMint/ Armey), Social Security Ownership and Guarantee Act	carveout; participation voluntary	3%-8% diverted from OASDI; additional voluntary contributions allowed	Personal Savings Board appointed by President	options selected by Board; stock/bond mix of 60/40 generally required	OASDI benefit	taxable	tax-deferred	tax-deferred amounts taxable on same basis as OASDI benefits
H.R. 4022 (Matsui), President's. Commission Reform Model 1	carveout; participation voluntary	2% from taxes diverted from OASDI	government board like TSP's or Federal Reserve Board; can invest privately once account balance above min. threshold	broadly diversified portfolio; only annual reallocation allowed	none	taxable	tax-deferred	tax-deferred amounts taxable on same basis as OASDI benefits
H.R. 4023 (Matsui), President's Commission Reform Model 2	carveout; participation voluntary	4% from taxes diverted from OASDI, not to exceed $1,000	government board like TSP's or Federal Reserve Board; can invest privately once account balance above min. threshold	broadly diversified portfolio; only annual reallocation allowed	none	taxable	tax-deferred	tax-deferred amounts taxable on same basis as OASDI benefits

Bill no. (sponsor), and short title	SSIA relationship to OASDI	SSIA contribution rate (pct. of wages subject to OASDI tax)	SSIA fund management	SSIA investment choices	SSIA minimum benefit guarantee	Federal income tax treatment of SSIA: Contributions	Investment earnings	Withdrawals
Bills introduced in 107th Congress (continued):								
H.R. 4024 (Matsui), President's Commis-sion Reform Model 3	both carveout and add-on features; participation voluntary	participant may contri-bute additional 1%, matched by 2.5% (up to $1,000) from taxes diverted from OASDI; partial rebate of 1% through tax credit for lower-wage workers	government board like TSP's or Fed-eral Reserve Board; can invest private-ly once ac-count balance above min. threshold	broadly diversified portfolio; only annual reallocation allowed	none	taxable	tax-deferred	tax-deferred amounts taxable on same basis as OASDI benefits
S. 2693 (Dorgan), Social Security Plus Account Act	add-on; participation voluntary	up to $2,000, offset in part by 20% refundable tax credit; matched by government payments if low income; sum of indi-vidual and matching contributions limited to $2,000	private IRAs	all securities eligible for IRA investments	none	employee share taxable; government share tax-deferred	tax-deferred	tax-deferred amounts taxable on same basis as OASDI benefits

Notes: Dollar amounts in table for contribution limits and tax rules are annual amounts.

Abbreviations used in table are as follows:

AIME–average indexed monthly earnings

G,F,C – funds invested in government securities, fixed income securities, and corporate stocks, respectively

IRA – Individual retirement account
OASDI – Old Age, Survivors and Disability Insurance
PIA – Social Security primary insurance amount
SAFE – proposed *Savings Account for Every American*
SEC – Securities and Exchange Commission
SSA – Social Security Administration
SSIA – Social Security Individual Account
TSP – Thrift Savings Plan