

# CRS Issue Brief for Congress

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## **Social Security Reform**

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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 2037 and only 72% 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 2075 it would be 46% 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 75%. In contrast, the number of workers supporting the system would grow by 13%.

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 \$6 trillion in 2024. The system's outgo would thereafter exceed its income and the trust funds would fall until their depletion. However, the trustees project that the system's taxes by themselves would fall below its outgo in 2015. At that point, other federal receipts would be needed to help pay for benefits (in effect making good on the federal bonds held by the trust funds). If there are no other surplus governmental receipts, policymakers would have three choices: raise taxes or other income, cut spending, or borrow the money.

Mirroring this adverse outlook are 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 widespread perception that Social Security may not be as good a value in the future as it is today. These concerns and a belief that a remedy lies partly in increasing

national savings have led to proposals to substantially 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 105<sup>th</sup> and 106<sup>th</sup> Congresses.

In his January 2000 State of the Union message, President Clinton renewed his call for crediting the Social Security trust funds with general revenues equal to the interest savings achieved by using Social Security surpluses to buy up publicly-held federal debt. In his 1999 message, he had proposed general fund infusions equal to a little more than half of the next 15 years' overall budget surpluses. Under both proposals part of the trust funds were to be invested in stocks. Presidential candidate George W. Bush favors allowing workers to put some of their Social Security taxes in personal accounts where they could invest in stocks if they desired to. Presidential candidate Al Gore supports the President's plan, but not the part calling for investing the trust funds in stocks. He does endorse, however, the creation of personal accounts with government matching contributions, which workers could invest in stocks.

## MOST RECENT DEVELOPMENTS

*In his State of the Union message in January, the President renewed his call for crediting the Social Security trust funds with interest savings achieved by using Social Security budget surpluses to reduce publicly-held federal debt. In his earlier 1999 message, he proposed using more than half of projected federal budget surpluses over the next 15 years to shore up the system — a portion of which was to be invested in the stock market. Critics raised concerns about Government ownership of private companies, which they contended ran counter to the nation's free enterprise system. He also proposed that part of the budget surpluses be used to create new personal Universal Savings Accounts to supplement Social Security benefits. Although little action on the issue is expected during the remainder of this Congress, Social Security reform has emerged as a significant issue in the 2000 Presidential race. Presidential candidate Al Gore supports the President's latest plan but not the part calling for investments in stocks. However, he endorses the idea of creating personal accounts with government matching contributions, which people could invest in stocks. Presidential candidate George W. Bush favors allowing workers to put some of their Social Security taxes into personal accounts which could be invested in stocks.*

## BACKGROUND AND ANALYSIS

Although Social Security's income is currently exceeding its outgo, its board of trustees — consisting of three officers of the President's Cabinet, the Commissioner of Social Security, and two members representing the public at large — project that on average over the next 75 years Social Security's outgo will exceed its income by 14% and by 2037 its trust funds would be depleted. In 2037, incoming revenues could pay for only 72% of the benefits prescribed by current law. The primary reason is demographic: an aging post-World War II baby boom generation will begin retiring in less than 10 years and increasing life expectancy is creating an older society. By 2025, the number of people age 65 and older is predicted to rise by 75%. In contrast, the number of workers whose taxes will finance future benefits is projected to grow by only 13%. As a result, the number of workers supporting each recipient is projected to fall from 3.4 today to 2.1 in 2030.

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 federal securities are redeemed and Treasury makes up the difference with other receipts.

Currently, more Social Security taxes are being paid into the Treasury than are needed to pay the benefits. These surpluses and the interest the government "pays" to the trust funds appear as growing trust fund balances. In their March 30, 2000 report, the trustees projected that the balances would grow to a peak of \$6 trillion in 2024. After 2024, the system's income would exceed its outgo and the balances would fall. By 2037, the trust funds would be exhausted and technically insolvent. Although the system's income is projected to exceed its outgo through 2024, the point at which Social Security taxes alone (ignoring interest paid

to the funds) would fall below the system's outgo in 2015. Since interest paid to the funds is an exchange of credits among Treasury accounts, it is not a resource for the government; only the system's taxes are. Hence, in 2015 other federal receipts would be needed to help meet the system's costs. At that point, if there are no other surplus receipts, policymakers would have three choices: raise taxes, cut spending, or borrow the needed money.

Today, the cost of the system — \$410 billion in 2000 — is equal to 10.34% of the total amount of national earnings subject to Social Security taxation (referred to as taxable payroll). It is projected to rise slowly over the next decade, reaching 11.55% of payroll by 2010. It would then begin a more precipitous rise to 16.24% in 2025 and 17.86% in 2035. This would be near the end of the baby boomers' retirement, as those born in 1965 (the approximate end of the baby boom) would be 70 years old. After that, the system's cost would rise slowly to 19.53% of payroll in 2075. The system's average cost over the entire 75-year period would be 15.4% of payroll, or 14% higher than its average income. However, the gap between income and outgo would grow throughout the period and by 2075, income would equal 13.34% of payroll, outgo would equal 19.53% of payroll, and the gap would equal 6.18% of payroll. By 2075, outgo would exceed income by 46%.

Mirroring this adverse outlook are public opinion polls showing that fewer than 50% of respondents express confidence that Social Security can meet its long-term commitments. And accompanying this skepticism is a growing perception that Social Security may not be as good a value in the future as it is today. Until recent years, a typical retiree could expect to receive far more in benefits than he or she 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, it has become increasingly apparent that these favorable ratios will not continue in the future. These concerns and a belief that a remedy lies partly in increasing national savings have led to a number of major 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 be enacted to 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 financial problems similar to those now being forecast. Among them were constraints on the growth of *initial* benefit levels, a gradual increase from 65 to 67 in Social Security's *normal retirement age* (i.e., the age for receipt of full benefits), payroll tax increases, partial taxation of Social Security benefits of higher-income recipients, and extension of coverage to federal and nonprofit workers. Since that time, new long-term deficits have been forecast, resulting from changes in actuarial methods and assumptions, as well as extensions of the 75-year valuation period to later years (adding years of deficits at the back end of the period, while subtracting out recent years of surpluses).

A consensus appears to have emerged that action should be taken soon. This has been the expressed 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 held by a number of Committees 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 37 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 with something modeled after IRAs or 401(k)s. This broad spectrum was clearly reflected in a legislatively-mandated Social Security Advisory Council’s report in 1997, which presented three very different reform plans, none of which received endorsement by a majority of the Council’s 13 members. Similar diversity is reflected in the many bills introduced in the past two Congresses to deal with the issue.

**The Push for Major Reform.** Advocates of major reform see Social Security as an anachronism, largely 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 puts money away for retirement. They cite the vast economic, social, and demographic changes that have transpired over the past 70 years and point to changes made in other countries that now use market-based personal accounts as a way not only to strengthen retirement incomes but to bolster their economies by spurring savings and investments. They view government-run, pay-as-you-go systems as politically unsustainable when increasingly larger segments of population have to draw on them. They prefer a system of personal accounts that have people invest while they work for their own eventual retirement, in contrast to a system that would impose tax hikes on future workers to meet the financing burden of a pay-as-you-go system.

They also see it as a way of countering 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 since stocks and bonds generally have provided higher returns than are projected from the current system. Some feel that a system of personal accounts 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 a person’s contributions, yet because it is not means-tested, many of its social benefits go to well-to-do recipients. Still others argue that creating a system of personal accounts would prevent the government from using surplus Social Security taxes to “mask” government borrowing or spending (i.e., hide budget deficits in the rest of the government).

Others, not necessarily seeking a new system, see enactment of long-range Social Security constraints as one element of curbing federal entitlement spending. The declining ratio of workers to Social Security recipients (dropping from 3.4 to 1 today to 2.1 to 1 in 2035) is a manifestation of the broader decline in the ratio of the working age population to the largest group who will draw on entitlement programs, the elderly. The number of people aged 20-64 to those 65 and older is projected to fall from 5.1 to 1 in 1980 to 2.7 to 1 in 2035. With costs directly linked to an aging population, Social Security, Medicare, and Medicaid — the “big three” entitlements — are expected to grow rapidly. Proponents of imposing constraints on them fear that if left unchecked, their costs will place a large strain on the

federal treasury far into the future, co-opting resources that could be used for other national 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 get. They argue that to put off making changes until some later point when the financial stress is severe is unfair to today's workers, who not only must pay for "transfer" payments that are "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 retirement age, scaling back its benefits, 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 the current "crisis" atmosphere about the need to reform the system undermines public support for it. They contend that its problems are resolvable with modest tax and spending changes and that the programs' critics are raising the specter that it will "bankrupt the Nation" as 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.

Still others argue that a system of personal accounts would expose participants to excessive market risk for an income source that has become so essential to so many. 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 savings 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 not be conditioned on market risk. They further contend that the administrative costs of maintaining personal accounts could be very large and could significantly erode the returns people would realize.

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 savings 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.** Reformers of Social Security do not suffer from a lack of options. To the contrary, the three alternatives offered by the 1994-96 Social Security Advisory Council show that the range of choices is wide — from maintaining the current system to the maximum possible extent, to reducing its future commitments while mandating that workers save more on their own, to restructuring Social Security into a new two-tiered system, a major part of which would involve the creation of new personal accounts. A consensus has emerged that action needs to be taken soon. However, given the diverse views about what should be done, there is uncertainty about how quickly a consensus plan can be forged.

## Areas of Contention

**The System's Financial Outlook.** While adverse trustees' projections have persisted for the past dozen years or so, there are conflicting views over the severity of the problem. Some argue that the problem is more acute than the 14% average shortfall indicates. They point out that the system's costs are projected to exceed its receipts by 4.26% of taxable payroll in 2030, a difference of 33%. In 2075, the gap would be 6.18% of taxable payroll, or 46%. In other words, 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 37 years away (i.e., because the trust funds would not be depleted until 2037) ignores the financial pressure the system will place on the government much sooner. They argue that it will emerge when Social Security's expenditures exceed its taxes in 2015. It is 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. They also argue that looking only at Social Security's imbalance ignores the large financial strain that other entitlement programs — notably Medicare and Medicaid — will impose on the government. They argue that as the ratio of the working age population to the elderly drops, the burden on workers will rise significantly. Thus, they view the problem not only in terms of the system's actuarial imbalance but also by the large increase in expenditures it and other entitlement programs created by the demographic changes.

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 37 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 held, 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 contend that the real problem is that the government has spent Social Security surpluses on other programs in the past and may continue to do so unless they are protected. They



point out that as a share of GDP, the projections show the system's cost only rising from 4.19% today to 6.62% in 2030; including Medicare, it rises from 6.5% to 11%. While acknowledging that this would be a notably larger share of GDP, they argue that GDP itself would have risen by more than 50% 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 and bridge jobs already is becoming more prevalent and older workers are increasingly seeing retirement as something other than an all or nothing decision.

**Public Confidence.** Social Security's financial problems are mirrored in general skepticism about the system. Public confidence in the system's ability to meet its long-run commitments dropped after funding problems emerged in the 1970s and early 1980s. 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 for a few years following the 1983 legislation shoring up the system, it appears to have risen again in recent years with 55% voicing a lack of confidence in 1994. Younger workers were particularly skeptical; nearly two-thirds of those below age 55 voiced little confidence, compared to less than one-third of those 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, it was clear that Social Security recipients received a very good deal for the Social Security taxes they paid. Most received more, often far more, than the value of those taxes. 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 retire at age 65 in 2000, it will take 16.7 years. For those retiring in 2025, it will take 27.4 years (based on the trustees' intermediate forecast.) Some observers feel these discrepancies are grossly inequitable and cite them as evidence that the system needs to be substantially restructured.

Others, however, discount their importance, 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 by design 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 societal worth of these aspects of the system is not valued in simple calculations of taxes paid and benefits received.

**“Privatization” Debate.** Concerns about 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. The three alternative plans of the recent Advisory Council all featured some program involvement in the financial markets. The first, the “maintain benefits” plan, called upon Congress to consider authorizing investment of part of the Social Security trust funds in equities (the assumption being that stocks would produce a higher return than the treasury bonds the system now invests in). The second, the “individual account” plan, would have required 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, the “personal security account” plan, would have redesigned 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).

Another approach garnering considerable attention is the reform that Chile enacted in 1981. It replaced a troubled state-run, pay-as-you-go system with one requiring most workers to invest part of their earnings in personal accounts through government-approved pension funds. Similar approaches for reforming the U.S. system, and scaled-down versions that would run in conjunction with the existing system, are reflected in 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.

Still another approach, reflected in recent bills would require that future budget surpluses be used to set up personal accounts to supplement Social Security benefits for those who currently pay Social Security taxes. They proposed no changes to the existing system. The President’s January 1999 reform plan included a similar approach, allocating a portion of the surpluses to new personal accounts supplemented by a worker’s own contributions and a government match (scaled to income). The new accounts were to be targeted toward low and moderate income workers.

Another approach, reflected in the President’s reform proposals, calls 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. This is similar to the approach suggested in the Advisory Council’s “maintain benefits” plan and in a number of recent bills. In most of these plans a new independent board would be required to invest some of these new funds in the stock or corporate bonds and the rest in federal securities.

Many proponents of moving to personal accounts see it as a way of reducing future demands for governmental financing and countering skepticism about the existing system by giving workers more of a sense of ownership of their retirement savings. Others feel that it would yield a better retirement income for workers since 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 a person's (and his or her employer's) contributions as a personal account would be, yet because Social Security is not means-tested, many of its social benefits go to well-to-do recipients. Still 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 oppose investing the Social Security trust funds in the markets because they fear it would concentrate too much economic power in a government-appointed board.

Opponents of personal accounts argue that Social Security's problems can be resolved without altering the program's fundamental nature. They fear that creating personal accounts in place of Social Security benefits 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, which provides annual cost-of-living adjustments, would provide poor protection against inflation. They 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.** There has been considerable interest in recent Congresses in raising the ages at which Social Security retirement benefits are payable as a means to address the system's long-range problem. Much of it stems from improvements in life expectancy since benefits were first paid in 1940. Back then a 65-year-old man was expected to live another 11.9 years; for a woman, it was 13.4. Today, life expectancy at 65 is 15.9 years for a man and 19.2 for a woman, and by 2030 it is projected to be 17.5 and 20.4 years for a man and woman respectively. This trend made increasing Social Security's full benefit age an attractive means of achieving savings when the system was facing major financial difficulties 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 longevity improvements. Opponents say it will penalize today's workers who already get a worse deal from Social Security than do current retirees, those who work in arduous occupations, and those who are members of racial minorities having shorter life expectancy.

**Cost-of-living adjustments (COLAs).** Social Security benefits and those of a number of other major entitlement programs, as well as various aspects of the income tax system, 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). It measures price increases for selected goods and services purchased in the economy. In recent years the CPI has come under criticism for allegedly overstating the effects of inflation, notably because the market basket of goods and services

underlying the index was not being revised regularly to reflect changes in consumer buying preferences or improvements in quality. A BLS analysis in 1993 found that the overstatement might be as much as 0.6 percentage points annually. CBO estimated in 1994 that the overstatement ranged from 0.2 to 0.8 percentage points. A 1996 panel studying 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 budget goals set annually by Congress. 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. With the President's urging last year that future unified budget surpluses be reserved until Social Security's problems are resolved, and his proposals to use a portion of the next 15 years' projected surpluses to shore up the system, Social Security's budget treatment has become a major policy issue. Congressional views about what to do with the budget surpluses are diverse — ranging from “buying down” publicly-held federal debt to cutting taxes to increasing spending. However, support for setting aside the portion attributable to Social Security is substantial and has made Social Security reform a place holder in much of the current fiscal policy debate. Last year, Congress passed a FY2000 budget resolution — H.Con.Res. 68 — that incorporated budget totals setting Social Security surpluses aside for the next 10 years. They went on to consider, but did not pass, additional so-called “lock box” measures that would create procedural obstacles for bills that would divert the portion of the budget surpluses attributable Social Security for tax cuts or spending increases pending consideration of legislation “enhancing retirement security.” A similar policy of setting the Social Security surpluses aside is reflected in the FY2001 budget resolution, H.Con.Res. 290, passed by Congress this year, and a new lock box bill, H.R. 3859, has been passed by the House. On September 18, 2000, the House of Representatives passed H.R. 5173, *The Debt Relief Lock-Box Reconciliation Act for Fiscal Year 2001*, which would reserve Social Security and Medicare surpluses for debt reduction until reform legislation is passed. Provisions similar to those in H.R. 5173 were included in H.R. 5203, *Debt Relief and Retirement Security Reconciliation Act*, passed by the House on September 19, 2000. (For more information, see CRS Report RS20165.)

In 1998 the House Republican leadership attempted to define partial use of the budget surpluses with passage of a tax cut bill, H.R. 4579, and a companion measure, H.R. 4578, that would have created a new Treasury account (the “Protect Social Security Account”) to which 90% of the next 11 years' projected surpluses would have been credited pending Social Security reform. The underlying principle was that 10% of the budget surpluses be used for

tax cuts and the remainder held in abeyance until Social Security reform was enacted. However, both bills were heavily opposed by Democratic Members, who argued for 100% of the surpluses being held in abeyance pending Social Security reform. The Senate did not take up either measure before the 105<sup>th</sup> Congress adjourned.

Earlier in the 105<sup>th</sup> 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.

## **Congressional Initiatives**

In the past several Congresses a large number of reform bills have been introduced. During the 103<sup>rd</sup> Congress, various bills would have raised the system's full benefit age to 70, reduced COLAs, and made other benefit reductions — H.R. 4275 (Pickle), H.R. 4372/H.R. 4373 (Penny), and H.R. 5308 (Nick Smith). H.R. 4245 (Rostenkowski) sought a mix of benefit reductions and tax hikes. In the 104<sup>th</sup> Congress, more far-reaching proposals not only encompassed some of these changes, but also sought to privatize a portion of the program — S. 825 (Kerrey and Simpson), H.R. 3758 (Nick Smith), and S. 818 (Kerrey).

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 have kept the system's benefit structure essentially in tact by addressing most of its long-range problem with revenue increases (including an eventual rise in the payroll tax) and minor benefit cuts. To close the remaining gap, its proponents suggested that Congress consider authorizing investment of part of the Social Security trust funds in stocks. The second (the "individual account" plan) addressed the problem mostly with benefit reductions, and in addition would have required 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 have gradually replaced the current earnings-related retirement benefit with a flat-rate benefit based on length of service and personal accounts funded with a 5% of pay contribution (carved out of the current payroll tax). It would have covered the costs of transitioning to the new system with a 1.52% of pay increase in payroll taxes and government borrowing. While Congress has not taken action on any of the Advisory Council's plans, the Council's report and varied plans have served to stimulate public debate. The conceptual approaches they reflect can be found in many reform bills introduced in the 105<sup>th</sup> and 106<sup>th</sup> Congresses.

In his State of the Union message this year, President Clinton renewed his call for crediting the Social Security trust funds with interest savings achieved by using Social

Security's share of looming budget surpluses to reduce publicly-held federal debt. In his 1999 message, he had proposed using \$2.8 trillion of the \$4.9 trillion in projected budget surpluses over the next 15 years to shore up the system — nearly \$.6 trillion was to be invested in the stock market, the rest in federal securities. The proposal was estimated to keep the system solvent until 2059. Critics raised concerns about the Government's ownership of private companies, which they argued ran counter to the nation's free enterprise system. The President further proposed elimination of the Social Security earnings test and unspecified measures to reduce poverty among elderly women. He also proposed that \$.5 trillion of the budget surpluses be used to create new Universal Savings Accounts (USAs) — 401(k)-like savings accounts intended to supplement Social Security benefits. 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 — some \$543 billion in the FY2011-2014 period, followed by \$189 billion annually thereafter. The infusions were to be invested in stocks until the stock portion reached 15% of the trust funds' holdings. The plan was projected to keep the system solvent until 2053. In October 1999, he revised the plan again by dropping the stock investment idea — all the infusions were to be in the form of federal bonds. His latest plan is similar but again calls for investing up to 15% of the trust funds in stock.

Social Security reform also has emerged as a significant issue in the 2000 Presidential race. Presidential candidate Al Gore supports the President's latest plan but not the part calling for investments in stocks. However, he endorses the idea of creating personal accounts with government matching contributions, which people could invest in stocks. Presidential candidate George W. Bush favors allowing workers to put some of their Social Security taxes into personal accounts where they could invest in stocks if they desired to.

Although major action on the issue is unlikely in the remainder of this Congress, a number of Social Security changes have been 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 is considering 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 made up to 85% of benefits taxable for some recipients. H.R. 4865, recently passed by the House, would repeal that measure, and thereby limiting the taxable portion of benefits to 50% (see CRS Report RL30581).

**Reform Bills and Other Proposals.** Most numerous amongst the Social Security bills introduced in the 106<sup>th</sup> Congress are ones to alter Social Security's treatment in the federal budget — more than 40 bills would do so. Included among them are the budget "lock box" measures mentioned earlier. A second group would address the system's problems directly with some combination of benefit restraints and income-producing measures. Many also would make some use of the nation's financial markets, either by creating new personal savings accounts to supplement or take the place of part of future Social Security benefits, or by permitting the investment of the trust funds in the markets. A third group would replace the current system with personal accounts. Some in this group would phase-in the personal accounts rapidly, giving workers bonds for their past Social Security taxes, while

others would have a long transition. A fourth group would create personal accounts to provide a new form of retirement income to offset Social Security constraints that may eventually be needed to restore the system's solvency. They do not contain specific measures to alter the system. The following summarizes these proposals.

H.R. 249 (Sanford) and H.R. 874 (Porter) of the 106<sup>th</sup> Congress would allow workers to divert eight and ten percentage points, respectively, of the combined OASI tax rate on employees and employers into new personal accounts. Under H.R. 249, workers who opt for the new system would receive Social Security benefits equal to what they would have received had they turned age 62 and retired in the year 2000 and a minimum annual annuity from their personal accounts. For those remaining in the old system, the bill would gradually raise the full benefit age to 70, alter the basic benefit formula to produce lower benefits, reduce annual COLAs and spousal benefits, and extend Social Security coverage to newly hired State and local government workers. Under H.R. 874, workers opting for the new system would receive Social Security benefits (through recognition bonds) based on their employment record before they joined and a minimum annuity from their new personal accounts. For those remaining in the old system, the bill would gradually raise the full benefit age to 70 and alter the basic benefit formula to produce lower benefits.

S. 1103 of the 106<sup>th</sup> Congress (Rod Grams) and H.R. 3683 (Sessions) of the 105<sup>th</sup> Congress would similarly allow workers to opt for a new system of personal accounts. S. 1103 would allow them to divert 10 percentage points of the combined employee/employer tax rate into new accounts. Workers age 30 and older would receive recognition bonds for past Social Security taxes. Those choosing the new system could opt back into the old one within 10 years upon repayment of the taxes and any recognition bonds received. H.R. 3683 would allow workers to divert 6.2% of pay — the employee share of the Social Security tax — into new personal account. Employers would continue to pay their share of the tax to the old system for 15 years, after which they would contribute to the worker's personal account. There would be a 90-day period of dual coverage, after which the worker's Social Security coverage would decline by 20% per year until all protections were forfeited in the 5<sup>th</sup> year.

H.R. 250 and H.R. 251 (Sanford), of the 106<sup>th</sup> Congress would mandatorily divert one percentage point of the Social Security tax rate on workers into new personal savings accounts (for those under age 55 upon enactment) managed by the Treasury in the same manner as the federal workers' Thrift Savings Plan (with the same investment options) or by banking institutions. Future Social Security benefits would be scaled down to take account of the growth of the accounts. They also gradually raise Social Security's early and full retirement ages to 67 and 70, respectively, for those born in 1967 (thereafter increasing them by about one month every 2 years), and reduce COLAs.

H.R. 4839 (Sanford) of the 106<sup>th</sup> Congress would mandatorily divert an amount derived from annual Social Security surpluses into new personal savings accounts (for those under age 55) with between 5 and 15 investment options to choose from. Future Social Security benefits would be scaled down to take account of the growth of the accounts. Provides for general fund infusions to the DI trust fund if the balance falls below 20% of annual costs.

S. 21 (Moynihan/Kerrey) of the 106<sup>th</sup> Congress would put the current system on a pay-as-you-go basis by immediately reducing the tax rate by one percentage point each on workers and their employers, and then raising it later in tandem with the system's future cost.

Workers would be given the option of using the tax cut to create new personal accounts. If they did, their employers would have to match their contributions. The bill also would reduce COLAs, increase and extend the taxation of benefits to all recipients, repeal the currently scheduled increase in the full benefit age while constraining the future growth in benefits to reflect increasing life expectancy, lengthen the earnings “averaging period” for computing benefits, eliminate the Social Security earnings test (allowing recipients to receive benefits regardless of their earnings), raise the maximum amount of earnings subject to taxation, extend Social Security coverage to all newly hired State and local government workers, and create a new system of personal savings accounts for children under the age of 6, referred to as *kidsave* accounts, funded with contributions by the government.

S. 588 (Bunning) of the 106<sup>th</sup> Congress would allow workers to initially divert 2.5% of their OASDI taxes (employee share only) into new personal accounts with the diversion amount rising to up 50% over 20 years. Workers opting for the new system would be required to take a 50% reduction in their Social Security benefits. Retirees would be required to draw down at least 75% of their personal account accumulations in the form of an annuity or other monthly payment based on their life expectancy.

Senator Phil Gramm has proposed a plan where workers would be allowed to divert three percentage points of their Social Security tax rate into new personal accounts with the government guaranteeing a higher income than would be payable from Social Security alone. The guarantee would apply when a retiree’s Social Security benefits plus an annuity from the new accounts are less than 120% of current law Social Security benefits. An additional 2% of workers’ pay would be contributed to the accounts by the Federal government, and the annuities from these contributions would be used entirely to offset the cost of a worker’s eventual Social Security benefits. Federal budget surpluses, a partial draw down of the Social Security trust funds, and higher corporate tax receipts resulting from the potential economic stimulus created by the plan were suggested as ways of covering transition costs. The Senator suggested that the plan may resolve Social Security’s funding problems since the personal account annuities would fully or partially offset Social Security benefits.

Economists Martin Feldstein and Andrew Samwick also proposed a personal accounts system funded with federal budget surpluses allocated to workers at a rate equal to 2% of their pay. Under their plan, withdrawals from the accounts would cause a partial reduction in Social Security benefits; i.e., for every \$1 withdrawn, \$.75 in Social Security benefits should be forfeited. In this way, the build up of the accounts would lead to an eventual reduction in the existing system’s cost while enhancing future retirees’ income. A related approach suggested by Representatives Archer and Shaw would establish a personal accounts system, referred to as Social Security “guarantee accounts,” funded with indefinite government contributions equal to 2% of pay. The government would establish the accounts for all workers who pay Social Security taxes. However, workers’ Social Security taxes would be unaffected, since the funding of the accounts would be through refundable tax credits (the accounts would be effectively 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 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 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 above the full benefit age.

S. 2313 (Gregg/Breaux) and H.R. 4256/H.R. 4824 (Kolbe/Stenholm) of the 105<sup>th</sup> Congress would mandatorily divert two percentage points of the Social Security tax rate on workers into new personal accounts (for those under age 55). To assist with program financing, they extend Social Security coverage to newly-hired State and local government workers and credit proceeds from the current income tax on benefits to the Social Security trust funds that now go to the Medicare HI trust fund. They reduce the system's outgo by raising the early and full benefit ages gradually to 67 and 70, thereafter increasing them by 2 months every 3 years, altering the basic benefit formula to produce lower benefits, reducing the dependent spouse's benefit, lengthening the earnings averaging-period for computing benefits, and reducing COLAs. They also would create a new system of minimum Social Security benefits, eliminate the Social Security earnings test for recipients above the full benefit age, and create new voluntary personal savings incentives.

Representatives Kolbe and Stenholm have introduced a revised proposal in the 106<sup>th</sup> Congress, H.R. 1793, representing a modification of their previous bills. While retaining many of the same or similar provisions (including the two percentage point tax "carve out" for new personal accounts), the new bill does not contain measures extending Social Security coverage to State and local government workers and reducing the dependent spouse's benefit. It revises the provisions to increase the early and full benefit age, such that after the full benefit age reaches 67 in 2011, both it and the early benefit age would rise to reflect increases in life expectancy. It also includes two new benefit formula constraints substantially limiting the future growth of benefits and revises provisions creating voluntary savings incentives to direct them toward low-income workers. To assist with program financing, the bill calls for general revenue infusions to the Social Security trust funds rising from amounts equal to 0.4% of pay in 2000 to 0.8% in 2060 and thereafter.

Senators Gregg and Breaux (with cosponsors) also have introduced a revised proposal, S. 1383. It raises the full benefit age to 67 somewhat faster than current law and creates greater reductions and increases for early and delayed retirement. In lieu of further age increases, it constrains the future growth in benefits, as in S. 21. It would retain a 2% of pay tax carve-out for new personal accounts, however, in contrast to their previous bill, some of the annuities from the accounts would cause a reduction in future Social Security benefits. In addition, in lieu of creating a new minimum benefit, it creates a new benefit formula tilted more heavily toward low-wage workers. The plan also calls for creation of "kidsave" accounts as in S. 21 (with half of the eventual annuities causing a reduction in Social Security benefits), and revises voluntary savings provisions in the previous bill by adding a government contribution and matching rate for low-income workers. To assist with financing, it would raise the maximum amount of earnings subject to Social Security taxation and make permanent general fund infusions to the trust funds. As with H.R. 1793, it excludes provisions contained in the previous bill to extend Social Security coverage to State and local government workers and reduce the dependent spouse's benefit. (Also see S. 2774, introduced by same sponsors in the 106<sup>th</sup> Congress – similar bill with some modifications).

H.R. 3206 (Nick Smith) of the 106<sup>th</sup> Congress would allow workers to put 2.5 percentage points of their Social Security taxes into new personal accounts for the next 25 years, 2.75 percentage points from 2026 to 2038, and an amount thereafter based on the yearly excess of aggregate Social Security revenue over expenditures. At retirement, each participant's Social Security benefits would be reduced by the amount of a hypothetical annuity derived from their accounts. The bill would alter the existing system by accelerating the scheduled increase in the full benefit age to 67 for those born in 1949, thereafter increasing it by 1 month every 2 years, and make changes to the basic benefit formula to produce lower *initial* benefits such that ultimately there would be nearly a single-rate benefit formula. It also would raise benefits for surviving spouses by 10% beginning in 2001, increase the "delayed retirement credit" to 8% per year beginning in 2000 (instead of in 2008 as scheduled under current law), extend Social Security coverage to newly hired state and local government workers, eliminate the Social Security earnings test for recipients age 62 and older, and make general fund infusions to the trust funds equal to non-Social Security budget surpluses for FY 2001-2009 and for a portion of the costs of disability insurance.

Not all proposals attempt to close the system's funding gap. S. 263 of the 106<sup>th</sup> Congress (Roth) and H.R. 3456 (Kasich) and S. 2369 (Roth) of the 105<sup>th</sup> Congress would create personal accounts funded with budget surpluses that would be considered supplements to Social Security for those who pay Social Security taxes. These proposals assume no changes to the existing system. The expressed view is that Social Security will have to be changed at some point, and the creation of these accounts could help fill the gap in benefits caused by those eventual changes. A similar measure to create *universal savings accounts* (USAs) using a portion of the budget surpluses is incorporated in a proposal the President recommended last year. The plan would have targeted USAs toward low and moderate-income workers, combining government contributions of \$300 annually to workers having at least \$5,000 in earnings with voluntary worker contributions matched by the government on an income-scaled basis (the lower the income, the larger the match). The combined worker/government contributions would be limited to \$1,000 a year (\$2,000 for a couple). These accounts were to have no effect on the size of a worker's Social Security benefits. In his Presidential campaign, Vice President Al Gore endorsed a similar concept.

Another approach would create a board to invest part of Social Security funds in stocks. The idea is that a managed fund taking advantage of higher yields from stocks would raise the income of the trust funds. It is incorporated in the President's various plans to credit the trust funds with a portion of federal budget surpluses, or alternatively, the interest savings from debt reduction, in the form of stocks. Following the theme of attempting to close the system's funding gap without altering Social Security benefits, this approach is similar to the Advisory Council's "maintain benefits" plan, to H.R. 633 and 990 (Bartlett), H.R. 871 (Markey), H.R. 1043 (Nadler), and H.R. 2717 (DeFazio) in the 106<sup>th</sup> Congress, H.R. 336 (Solomon) of the 105<sup>th</sup> Congress, and to proposals of former Social Security commissioner, Robert Ball, and Brookings economists, Henry Aaron and Robert Reischauer. A related approach (of increasing the system's income but not altering benefits) is reflected in S. 1376 (Hollings) calling for creation of a 5% value added tax that would be used to retire the federal debt and help shore up the Social Security trust funds.

Also embedded in the President's various plans and to a more limited extent in H.R. 147 (Ralph Hall) and H.R. 160 (Royce) in the 106<sup>th</sup> Congress and H.R. 2191 (Neumann) in the 105<sup>th</sup> Congress, is a proposal to buy up federal securities in the financial markets (i.e.,

outstanding federal debt) and credit an equivalent amount of federal securities to the Social Security trust funds. The various bills introduced simply call for replacement of the trust funds' nonmarketable securities with marketable federal ones. The President's plans call for adding new securities to the trust funds as general fund infusions.

## LEGISLATION

### **P.L. 106-182 (H.R. 5)**

Repeals Social Security earning test at ages 65-69 in 2000. Passed House, March 1, 2000, 422-0. Passed Senate, March 22, 100-0. Bill with Senate technical amendment passed House, March 29, 419-0. Signed into law April 7, 2000.

### **H.J.Res. 32 (Ryan)**

Social Security Guarantee Initiative. Joint resolution expressing sense of the Congress that President and Congress should join in Social Security Guarantee Initiative to strengthen and protect retirement income security of all Americans through creation of a fair and modern Social Security Program for the 21st century. Passed House, 416-1, March 2, 1999.

### **H.Con.Res. 68, (Kasich, et al.); S.Con.Res. 20, (Domenici, et al.)**

Establishes congressional budget for FY2000 and setting budget levels for FY2000-2009. Conference agreement passed House 220-208, April 14, 1999; passed Senate 54-44, April 15, 1999. In addition to establishing budget totals setting aside Social Security surpluses, calls for creation of Social Security "safety deposit box."

### **H.R. 1259 (Herger, et al.)**

Amends Budget Act of 1974 to protect Social Security surpluses through strengthened budgetary enforcement mechanisms. Passed House, May 26, 1999, 416-12.

### **H.R. 3859 (Herger, et al.)**

Amends Budget Act of 1974 to protect Social Security and Medicare surpluses through strengthened budgetary enforcement mechanisms. Passed House, June 20, 2000, 420-2.

### **H.R. 4865 (Archer, et al.)**

Repeals legislation enacted in 1993 making up to 85% of Social Security benefits taxable for some recipients. Passed House, July 27, 2000, 265-159.

### **H.R. 5173 (Fletcher)**

Would reserve Social Security and Medicare surpluses for debt reduction until reform legislation is passed. In addition, it would reserve \$42 billion of the budget surplus not attributable to Social Security and Medicare in FY2001 for public debt reduction. Passed House, September 18, 2000, by a vote of 381-3.

### **H.R. 5203 (Shaw)**

Would reserve Social Security and Medicare surpluses for debt reduction until reform legislation is passed. In addition, it would reserve \$42 billion of the budget surplus not attributable to Social Security and Medicare in FY2001 for public debt reduction. Contains other unrelated provisions. Passed House, September 19, 2000, by a vote of 401-20.