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Social Security Fixes
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Department of Accounting and Information Management
4/27/05
I completed a study on the Social Security system concentrating on its current state and the solutions that have been offered to remedy the situation. While Social Security has been described as a crisis, I tried to examine the situation from the viewpoints of those who feel it has reached an emergency situation as well as those who feel the system is quite stable. Much of the report is a study of the private account system which President Bush has been advocating. Most of the arguments revolve around those who are in favor of the change to a new system versus those who feel maintenance of the traditional system is vital. Because of its dependence on current and continuously changing information, I gathered most of my research from news reports and studies. In particular, I used the studies of the President’s Commission on Social Security and the reports of the Social Security Advisory Board. My report is a compilation of information regarding the topic. I tried to gather as much factual, unbiased information as possible so the reader could come to their own conclusion. I came to the decision that the traditional system should be maintained unless a more concrete solution could be devised that overcomes the problems associated with private accounts. With that said; however, I hope I wrote a report that gives the reader the ability to come to a conclusion for himself.
The Social Security system in America is a critical source of income for millions of Americans. Although known best as the government system for retirement, Social Security also pays benefits to those qualifying for disability benefits, family benefits, and survivors benefits. Almost 45 million people receive benefits from Social Security. Disability benefits provide coverage to those with severe physical or mental impairment that prevents them from working or is likely to result in death. Family benefits are received by spouses and children of retired and disabled workers. Survivors' benefits are provided for the survivors of deceased workers including millions of children. The importance of these funds is obvious especially considering Social Security benefits provide 40% of the income of the aged and more than 50% of the income for two-thirds of the aged. For 18%, this payment is their only income. The program is facing serious funding issues in the near future.

The Social Security and Medicare Program Trustees report each year on the status of the programs and their projected conditions. Although Social Security's future is currently the issue, one must mention Hospital Insurance (HI) and the Medical Supplementary Insurance (SMI). As these program requirements continue to increase, the pressure on the federal budget will also continue to compound. In 2004, Social Security failed the long-range actuarial test with projected exhaustion in 2042. To analyze the problem, it is important to understand the program's setup. There are actually four separate trust funds which are the OASI, DI, HI, and SMI. The Trust Funds account for all program income and disbursements. Income is composed of taxes, premiums, and other income with the only disbursements being benefit payments and administrative costs. Any revenues not needed are invested in non-negotiable securities of the U.S. government. The
trust funds accumulate value with the interest from all the prior surpluses. Only the OASI and DI are directly related to Social Security; however, to reiterate, HI and SMI costs continue to increase particularly with the changes to Medicare enacted in 2003. With these increasing costs, more funding will be required from the general fund leaving less of a cushion for the other trust funds. In fact, from the period of 2003 to 2078, Social Security costs are expected to increase by one-half, but Medicare costs are expected to be five times as high as the present! Clearly, the Social Security problem is far more manageable than Medicare. The financial status of Medicare has become severely problematic, and as Social Security hardships increase, both programs will speedily increase their take from the general fund revenues.

The Social Security trust funds composed of OASI and DI are financed mainly through payroll taxes. Currently, these taxes are levied on both employer and employee at 5.3% for OASI and 0.9% for DI totaling 6.2% each. The taxes applied in 2004 on earnings up to $87,900. The costs of Social Security are growing, but tax income to the funds is not increasing in accordance, and payroll taxes are not scheduled to change. Estimates of the trust fund's future are made for both the short-term and the long-term. By taking into account changes in law and assumptions about other factors such as economic growth, wage growth, inflation, fertility, mortality, and costs of medical care, the Trustees determine projections. While the short term projections are fine, the long-range is dismal. Costs for Social Security and Medicare will begin to increase after 2010 due to the retirement of the baby-boom generations. Demands on Social Security will then grow slowly mostly due to increasing life expectancy.\textsuperscript{IV}
Another important fact to recognize is that current beneficiaries receive payments from the taxes of current workers. The benefits received; however, are determined based on wages a retiree earned during their working years. Retired workers receive a proportion of the earnings they earned. The amount replaced by Social Security varies according to their wage level. Lower wage earners have a higher portion of wages replaced when benefits are calculated. Currently, the tax revenue provides surpluses over the costs of benefits for those presently retired, but this situation will soon reverse and turn into a growing cash deficit as the baby boom generation retires. This deserves further explanation. Major demographic changes will occur when the baby boomers retire. There will be more retirees with relatively fewer workers paying Social Security taxes. The large numbers of baby boom generation workers make up a big group of those paying Social Security taxes. The oldest of this generation will turn sixty-five in 2011 and by 2038; there will be an eight percent increase in the percentage of the population over sixty-five. Furthermore, people are living longer. In 2030, the life expectancies are projected to be eighty-three years for males and eighty-six years for females. To further aggravate the problem, there will be fewer workers. This event is due to a slow down in the growth of the labor force due a decline in the birth rate. Also, the rapid growth of women entering into the workforce is expected to level off soon. Because of these two factors, the ratio of Social Security tax-paying workers to Social Security benefit-receiving retirees will substantially be reduced. This problem is certainly not only a U.S. phenomenon. In fact, the U.S. is expected to have the lowest ratio of older citizens to workers than any other major industrialized country. Possibly, other countries will provide examples and guidance in the way they address this pressing concern. According to long-range
actuarial estimates, the OASDI Fund must begin to use the interest of the Trust Fund assets in 2018 when benefit payments begin to exceed income. In 2029, the assets must be redeemed. Finally, in 2044, the Trust Fund is expected to be exhausted. At this point, the Social Security system will only be able to finance 73% of the needed payments. Furthermore, this trust fund is really only a promise from the Treasury to the Social Security administration. The key issue is not the amount in the trust fund balance but how much paying off the IOUs is going to cost future taxpayers. These assets are not actually readily available in a government bank account. These payments must be financed by increased taxation, increased Federal borrowing, or decreased government funding of other programs. In addition, the funding requirements of Medicare are only increasing which puts even more pressure on Federal funds.

Numerous solutions have been proposed to make Social Security solvent both in the near future and permanently. If no action is taken before insolvency, the two main alternatives are either large benefit cuts or large tax increases. There have been many different suggestions of ways to achieve lower benefits or higher taxes that are less drastic if undertaken now. These include reducing the Social Security cost of living adjustments, increasing the number of years used to calculate benefits, modifying the benefit formula, raising the retirement age, reducing benefits for those with higher incomes, raising the Social Security payroll taxes, or increasing the amount of earnings subject to the payroll tax. Both President Bush and Senator Kerry discussed Social Security and their ideas in the 2004 election, although neither was completely clear on their plans for the program.

Many politicians and consequently the media and often the public focus on the dates of trust fund exhaustion when benefits will no longer be fully paid. It is necessary to
be aware of the immediate future because both Social Security and Medicare will begin to draw from and increase their need for funding from the general treasury funds. In addition, as time passes, financing becomes increasingly problematic as options shrink. In the year 2018 when benefit payments begin to exceed income, the general fund will transfer to the trust funds approximately $577 billion dollars. Furthermore, the interest paid on the bonds or their redemption provides no new income.\textsuperscript{iv}

If no action is taken before insolvency in 2042, the two basic alternatives are large benefit cuts or large tax increases. Without any plan or alternate source of funding, the future of Social Security is grim. It is important to be aware of the magnitude of the situation; however, with that said, a complete overhaul is not necessarily the answer. The integral disagreement is this very issue regarding shoring up the original system versus altering the very ideas on the way the Social Security is administered. In 2001, the Social Security Advisory Board projected numbers pinpointing the facts at critical years of the program particularly in 2038 when the fund was projected to be exhausted. Currently, the year has been adjusted to 2042 which would require adjustments to these numbers; however, the general ideas and comparability of the numbers is certainly still valid.

Looking in terms of benefit cuts, the trust fund will only be able to pay about 73% of promised benefits in 2038. This requires a 27% reduction across the board reaching approximately 33% in 2075. In more tangible terms, the projected monthly benefit on average will decrease from $1,426 to $1,041 in 2001 dollars. Even more disturbing is the decrease for low wage earners who may only receive this one source of income. For low wage earners, the monthly benefit is projected to decrease from $864 to $631 in 2001 dollars. Of course, this will result in a lower standard of living and increased poverty rates.
The other alternative is to increase Social Security taxes which would allow for full benefit payments in 2038 and until 2075. The increase required in 2038 would be extremely drastic and would increase Social Security taxes by almost one-half from 12.4% to 17.8%. In 2038, an average wage earner with a salary of approximately $49,000 would see an increase in Social Security taxes of approximately $1,320 a year on both the worker and the employer. Furthermore, this only solves the problem until 2075 when further actions would be needed. This is a much greater burden on younger workers who will pay these higher taxes for long periods of time with little or no effect on retirees who no longer pay taxes.

Clearly, making changes now is the obvious solution to avoid these drastic measures. As time passes, the problem only increases while the options decrease. There are several reasons supporting changes sooner rather than later including fairness to generations, impact on workers and retirees, and planning for retirement. Ensuring changes that are as fair as possible should be a goal and is more easily achieved with prompter action. More choices on how to make changes are available at this time. With the benefit of time, change can be more gradual and prevents huge discrepancies in benefits and taxes between generations. Furthermore, the cost to repair the Social Security system can be spread more evenly over more workers and beneficiaries. The costs are the same, but delay only leads to a larger burden on later generations. In addition, it is also more equitable to all to allow as much notice as possible to adjust to the changes that reforms may require. Advance notice will allow everyone to plan better for retirement regarding career and investment decisions. Early action will provide less disruption in the labor market as both employers and employees will know the changes in benefits and taxes
that affect work, retirement, and hiring decisions. In addition to these effects on the economy pertaining to the labor market, early action will also allow less disruption to the economy in regard to consumption and savings. Finally, the American people should be able to have confidence in their government and in the Social Security system. The American people should be able to feel secure and to depend on this system to plan and find a solution to this problem of which they are aware so many years in advance.

There are many different proposals suggested to address the current problem of insolvency. These reforms affect revenues, benefits, or a combination of the two. While many of these reforms have other issues associated with them such as acceptance by politicians and fairness to citizens in varying financial situations, looking at all different reform options allows us to see all of the possibilities. Some people feel the entire system is in need of complete reform and favor the more drastic measures while others see a need to tweak the system with a combination of minor reforms. Although some reforms may not have the impact of others, a combination of a few minor changes could bring about the desired effects. For the Social Security system to maintain solvency, projected revenues must match the projected expenses. The Social Security Advisory Board actuaries have determined estimates of the impact that each change would have on the expected deficit. Most of the changes fall into the category of affecting benefits, affecting taxes, or are more major adjustments to the system itself.

Proposals that affect the benefits received by beneficiaries are almost universally unsupported by the public and politicians alike. President Bush stated that one of his key principles of any reform plan must require no change to benefits for retirees or near-retirees. Despite the dislike of reduced benefits, awareness of the possibilities is
important. These proposals affecting benefits include reducing the Social Security Cost of Living Adjustment, increasing the number of years used in calculating benefits, modifying the formula used to calculate initial benefits, speeding up the increase in normal retirement age or increasing the age further, and reducing benefits for workers with higher incomes.

With all the proposals, there are certainly other issues to take into account besides the impact on the deficit such as the share of impact on retirees versus workers as well as impact on people with different incomes. Certainly, though unpopular, changes that would burden a class are more feasible than changes that would put a group into dire poverty or unable to meet their basic needs. In some cases, this especially needs to be taken into account since the changes affecting a group would be cumulative.

Each year, Social Security benefits are increased for cost of living adjustments to reflect increases in the Consumer Price Index. Some experts believe the CPI is overstated. Possibly, the CPI could be retroactively updated with more complete data which would reduce the increase. Although this number seems incredible, a reduction in COLA of 1% in 2002 would eliminate 77% of the long-range deficit. This reform does affect both current and future retirees. The next proposal involves increasing the number of years used to calculate benefits. Currently, benefits are determined based on the highest 35 years of earnings. By using the highest 40 years, 22% of the deficit would be eliminated. This affects those who will become eligible for Social Security benefits after the change is enacted. Similarly to the preceding change, the formula used to calculate initial benefits could be adjusted. For example, an immediate 3% reduction would eliminate 20% of the deficit. This change too would apply only to those who become eligible after reform is enacted. A more well-known idea that has been discussed by Federal Reserve Chairman,
Alan Greenspan, is the proposal to speed up the increase in “normal retirement age” or to increase it beyond the age of 67. Presently, the “normal retirement age” has been adjusted to 67 for those who turn 67 in 2027. If this adjustment to 67 were moved up to 2016, 8% of the deficit would be eliminated. By going further and indexing the age to 70, 32% of the deficit would be eliminated. This change affects the level of benefits for these future retirees. Finally, a proposal has been discussed to reduce or eliminate benefits for workers with higher incomes. The amount of deficit reduction depends on the levels where the restrictions are imposed. For example, benefits could be reduced by 10% beginning at a family income of $40,000 with an additional 10% reduction for each $10,000 of income. This reduction applied on up to 85% of income would eliminate 89% of the deficit.

Another alternative would be to limit the COLA for those with higher incomes. This type of “means test” would apply to current and future beneficiaries after enactment. This proposal is very unpopular. In the 2004 election, there was some suggestion from opponents that Senator Kerry supported means testing. Actually, he had supported studying the issue in 1996 but had since decided against supporting this idea.\textsuperscript{xvi}

Other proposals offered to reform Social Security involve raising taxes. Both John Kerry and George Bush were against this idea before the election. More recently in December of 2004 as President Bush began to promote his plan for reform, he again reaffirmed this principle.\textsuperscript{xvii} Regardless, these are still possibilities that should be considered when studying the issues. Raising taxes can take many forms including possibly extending coverage to all government employees, increasing the portion of benefits subject to taxation, raising Social Security payroll tax rates, and increasing the amount of earnings subject to the Social Security tax. Extending coverage to new
employees of state and local government would then result in coverage of the largest excluded group with their own pension system. Although this is a change with less impact, covering new hires in 2002 would eliminate 11% of the deficit. In addition, increasing the percentage of Social Security benefits that are taxable would result in a significant improvement. Currently, benefits are taxable above certain thresholds, but by phasing out thresholds and adjusting taxation, 24% of the deficit would be eliminated. On the downside, most would pay more income tax; however, the structure of the income tax would still protect those with low incomes. Although it is unlikely to occur based on political stances taken recently, Social Security tax rates could be increased. The seventy-five year deficit would be eliminated if an increase had been implemented in 2002 from 12.4% to 14.4%. Another alternative would be to wait and increase it to 14.8% in 2020 and then additionally 2.4% in 2050 up to 17.2%. This would result in solvency, but the permanence of this solution is not clear. This plan also would disproportionately rest on the shoulders of the young. There would be no effect on those already retired or close to retirement, and the greatest burden would be on younger workers or those not yet working.

Another way to increase payroll taxes is to increase the amount of earnings that are subject to the Social Security tax. In 2001 when the report was compiled, earnings that exceeded $80,400 ($87,900 in 2004) were not subject to the payroll tax or used to determine benefits. This limit increases each year, but in 2001, only 84% of earnings were covered with the percentage falling each year. There are several different ways to adjust this factor. For example, making all earnings subject to the payroll tax but still using the limit for benefit computations eliminates the deficit. In a more equitable change, the additional earnings could be taken into account when calculating benefits still eliminating
88% of the deficit. Another possibility would be to determine a percentage of earnings that would be subject to the payroll tax. This could possibly increase revenue but be more acceptable to some who would rather see 90% of their income taxable versus their entire income. This reform would result higher paid workers paying more tax and therefore they also would receive a lower rate of return.

This solution has been suggested for different ends both as a solution to the financial problems facing the traditional system and to pay for the expense of privatization. Although some believed Senator Kerry strongly supported implementing this solution before the election, Kerry made the promise to not increase taxes for people making less than two hundred thousand dollars. This promise implied he was not in favor of this remedy, although possibly the ceiling on payroll taxes could have been lifted if he had only been referring to the income tax or took other actions to compensate for raising the payroll tax ceiling. In December, two of President Bush's top advisors refused to disagree with the possibility that the ceiling would be lifted to help cover the cost to partially privatize Social Security. Neither would say if Bush supported a proposal to help compensate for the accounts by raising or removing the tax cutoff. The White House Chief of Staff, Andrew Card, did say the president did not want to see it increased but did not commit to this guarantee.

There are other more broad and sweeping remedies for the Social Security problem. These involve less tweaking and more impact through government investment in the stock market, transfers from the general revenues, or the development of individual investment accounts. The government could invest Social Security reserves in the stock market. Currently the excess reserves are invested in long-term bonds which are projected to have a
real return of 3%. In the past century, the returns of the market have been about 7%, and if this continues, the results could decrease the need for benefit cuts or tax increases to remain solvent. The impact on the deficit would be dependent on the return on stocks in comparison to Treasury bonds. Furthermore, there would be many issues regarding the government's role in investments such as these. Another option to address the deficit would be a transfer of general revenues to the Social Security trust funds. If there is not a surplus in the general federal budget, this would require tradeoffs with other government expenses. This type of approach as discussed later appeared to be the one favored by Senator Kerry and others who oppose privatization and view Social Security as a more manageable problem.

The last two proposals involve the establishment of individual investment accounts. This option could either require or allow workers to invest a percentage of their payroll tax in individually owned private accounts or could be provided by the government using unified budget surpluses. Making IIA mandatory or voluntary would allow workers to control their investment, and returns would depend on the future market changes and personal investment choices. By replacing Social Security partially or fully with IIA, the accumulating benefit obligation would be reduced. With this said, the crucial argument resurfaces. Since Social Security must still pay benefits to retirees who already contributed, any transfer to IIA from the trust funds would increase the Social Security deficit during the transition. There would be a need for cuts in benefits or some source of additional income. Moreover, this additional funding is required on top of the benefit cuts or extra revenue needed to eliminate the deficit that is already projected. Another option in order to face only the existing deficit would be an increase in the payroll tax to establish
the individual accounts. If trust fund budge surpluses are used to establish IIA, this would not reduce the current deficit. Additional sources of revenue would be required to repay the trust funds as well as solve the existing deficit in the traditional system.\textsuperscript{xxiv}

Establishing Individual Investment Accounts (IIA) has probably been the most discussed proposal recently both during the 2004 presidential election and the re-election promises of President Bush.\textsuperscript{xxv} Although he has yet to back any specific proposal, the president advocates reforms that will allow workers to hold a portion of their Social Security taxes as a private investment.\textsuperscript{xxvi} A system of IIA to replace all or even a part of the current system would be a significant change from the current structure of the system.\textsuperscript{xxvii} Social Security was established as a defined benefit system with benefits determined from a formula and based on an individual’s earnings with the various risks shared collectively. This change to IIA would essentially be a defined contribution plan. IIA are more of a savings program with workers and employers contributing to an individual account.\textsuperscript{xxviii} Any plan that proposes IIA would require pre-funding which would add additional costs to workers as the new system is phased into operation. Current workers would be required to pay for two retirement systems at the same time. Payments must still be allocated to current beneficiaries, but also the new individual system would require funding.\textsuperscript{xxix}

This issue was a key area of contention during the 2004 election and is still unsettled. According to Senator John Kerry, the plan would leave a two trillion dollar hole in attempting to pay for two systems referring to the bipartisan Congressional Budget Office report. Bush has committed to no reduction in benefits, but the CBO states there would have to be a cut in benefits of 25%-40%. Assuming he stands by this promise, Bush
has not explained where the government will get the two trillion dollars of funds. With that said; however, if implementation of this system occurs, it only becomes more complicated with delay. In 2038, the payroll tax would need to be increased to 17.8% just to pay for the current system plus any additional amounts for a new system. If this new system is accepted, it is better sooner than later while the system can take advantage of the more than adequate financing that Social Security currently receives.

Proponents of IAA argue many reasons in favor of private accounts. They argue that workers may benefit from higher returns and contend that pre-funding would raise national savings and result in higher national income. Although further discussion of specifics is warranted, those opposed cite several reasons opposing IAA. Some opponents discuss concerns that the financial promises will not succeed while others speak of the change to private accounts as a violation of the intent of Social Security. Some of the more well-known arguments include the risk that beneficiaries will bear related to their personal circumstances, choices of investment decisions, and the general economic conditions. In addition, risks occur based on the way the account income is paid either in a lump sum or annuity. Some fear lump payments may be not handled with responsibility or even annuity payments could be outlived. In general, workers who have higher earnings and longer time in the workforce would be better off than lower wage earners or those who work fewer years.

As stated before, possible approaches for IIA include three alternatives. The existing system could be completely replaced by mandatory IIA. A second approach would substitute IAA for some of or the entire retirement portion but retain other parts such as survivors and disability. Finally, the last option would be to maintain the current
system but supplement this system with mandatory or voluntary IIA. The first option has not really been discussed seriously, and most discussion revolves around ideas relating to the other two options.

President Bush has come out strongly advocating reform that includes IIA. He said that younger workers should be allowed to take some of their own money and put it into a personal savings account to get a better rate of return. While he still promises to honor the commitment Social Security has to today's seniors, he maintains that a new, different approach is needed for young people. In 2001, President Bush formed a bipartisan commission to unanimously recommend reform plans that would make Social Security solvent. The principles he set forth to the commission were mandatory for any plan proposed. These principles required that there be no change to benefits for retirees or near-retirees, and the payroll tax must not be increased. The entire Social Security surplus must be dedicated only to Social Security. Furthermore, the government must not invest the funds of Social Security in the stock market. The disability and survivors components must be preserved. Finally, any reform plan must include individually controlled, voluntary personal retirement accounts. The commission developed three models all with the central element of personal accounts as part of a new Social Security system.

The commission discussed in its report several failings with the traditional Social Security system. Notwithstanding the fact that the financial future is in peril, the commission cited other problems with the current setup. Not only do they see a more secure financial future, they felt it would result in greater equity and protection of the vulnerable. The report states that demography is not always perfect, and it is clear that the ratios are moving out of the system’s favor. At one point, forty-two workers covered each
Social Security beneficiary. This ratio has decreased to approximately three and a half, and it is only falling. The FICA tax has been increased twenty times since its implementation, and in 1997 for example, 79% of the population paid more in payroll tax than income tax. Furthermore, the report refers to the unjust effects of the current system on minorities with shorter life spans as well as inequity for women. The report comes to the conclusion that the program needs to evolve and make changes.

Although motivations are unknown, results are not definite, and many other factors need to be taken into account, the vision described by many proponents sounds ideal and beneficial to many. During his 2000 Presidential campaign, then-Governor Bush discussed a Social Security program that would “give people security of ownership” and the “opportunity to build wealth which they will use for their own retirement and pass on to their children.” Democratic Senator Bob Kerrey echoed these positive sentiments when he said, “It’s very important, especially for those of us who have already accumulated wealth, to write laws to enable other people to accumulate it.”

To illustrate, the report provides an example where a worker voluntarily adds 1% on top of the present 6.2% with a 1% match contribution from the federal government. Due to the phenomenon of compound interest, a medium-earner retiring in 2052 would have accumulated a diversified portfolio of $523,000 in U.S 2001 dollars! It is imperative to recognize this result depends on many other factors including a sound financial market as well as the ability of both the worker and the government to contribute this additional 1%.

The Commission, President Bush, and other proponents of individual accounts tout a substantial number of benefits they would provide. They feel it is not only a solution to the financial problems traditional Social Security is facing, but that it also fixes many of
the other problems inherent in the traditional system and provides other additional benefits. The Commission felt that Social Security would be strengthened if it were modernized to include voluntary personal accounts. Retirement security would be enhanced because individuals could create and own wealth which would be passed on as inheritance. The system is inequitable because low-income groups often have shorter life spans, and their families cannot receive any of the payments they would have received. These communities with shorter life expectancies such as African Americans will benefit greatly from inheritable assets. Furthermore, many on both sides of the privatization issue feel that benefits currently paid to lower-income workers are too low. Two of the three plans of the Commission promise to increase benefits for low-income workers, and this would raise many of the elderly above the poverty level. The Commission also states that the individual investment accounts would improve the way women are treated under Social Security. Personal accounts would give property rights in the case of divorce, increase benefits for widows, and the anti-poverty benefits would disproportionately help women.

According to the Commission, the IIA would help in more general ways as well improving the economy and increasing personal security. They feel the IIA are better than direct government investment because they will increase national savings and provide an incentive for participation in the labor market. Furthermore, IIA would contribute toward fiscal sustainability of the system and a more permanent solution. In contrast, tweaking the current setup will still require adjustments further in the future. The individual accounts would also be a more permanent solution that would reduce government involvement in individual and some believe private money matters.
The Commission also cites the benefit to individuals who will have more control of decisions, knowledge of their finances, and possibly pride in self-sufficiency. They feel it is advantageous that individuals will now be able to pursue higher returns, and the IIA can increase expected benefits to its participants. The President’s Social Security framework allows workers to diversify their investments and minimize risk from political struggles and swings in the market. His plan also has the goal to provide equal opportunity for workers at all wage levels to invest. Currently, this is a luxury only 50% in the U.S. can afford. Another integral part of the setup would allow workers to be well-informed about their financial situation. Workers would be required to receive quarterly benefit statements with information about their individual accounts including the value of their assets, rights to diversify, and the need to diversify. Furthermore, workers would be given access to investment advice.

When discussing these benefits, some could argue they are idealistic visions and overly optimistic. Supporters of IIA such as President Bush refer to the success of an innovation known as the Thrift Savings Plan. The Thrift Savings Plan is part of a retirement program for federal employees which was enacted in 1986. The timing was excellent, and the result for these workers has been extraordinary. The structure of this program provides an example of what supporters of IIA believe will occur for Social Security. Workers were allowed to choose from three funds in any combination. These funds included short-term, non-marketable U.S. Treasury securities, a commercial bond index, and an equity index fund. The rates of return were 6.7%, 7.9%, and 17.4% respectively. Furthermore, the administrative expenses are efficient and minimal, and participation at the end of 2000 was at a level of 86%. More recent results of the
program have not been as positive. The funds performed well in the 1990s with some return up to 43%, but in the 2001 recession and afterward, annual losses have been as high as 22%. However, all of the funds have made profits over the course of ten years. The commission stated in its report that while there continue to be risks and fluctuations, the market economy looks to have settled down to impressive long-term growth.

The commission not only completed research and discussed ideas, but they also completed three possible reform models that adhere to President Bush's principles. These models have some unifying elements. All have personal accounts as a central element and project benefits that are at least as high as those for today's beneficiaries. According to the commission, all three plans improve the fiscal sustainability of the program, all require investments to move to individual accounts, all reduce the future need for general revenues, and all are expected to increase national savings. The overriding goal of all three is to move toward sustainability and respond to the future.

Bush has campaigned for a Social Security overhaul for five years, but he has not yet provided any specific details for a plan. He did not endorse any of these three recommendations from the commission. Despite the fact he did not endorse any of these models, it is likely President Bush and others support much of the ideas and aspects presented. Although a specific plan has not been decided, the administration is leaning towards letting workers divert 4% points of their payroll tax-almost two-thirds-into investment accounts which is similar to reform model number two. Even if this is not the case, reform model two provides a good, detailed example about some of the specific changes that would occur as well as the promises supporters are making to the country. Specifically, 4% of payroll tax can be redirected (up to $1000 annually and indexed for
growth) to an IIA. The traditional Social Security benefits will be offset by the IIA contributions compounded at an interest rate 2% above inflation. Overall, the promises sound excellent. Future retirees receive Social Security benefits that are as high as current retirees. Voluntary personal accounts are established without increasing the payroll tax or mandating worker contributions. Participants can choose a mix of investments in order to have a diversified portfolio. The account will be split in the case of divorce. These accounts can be owned and bequeathed to heirs. Furthermore, benefits are increased for those with lower incomes. The plan expects that by 2018, minimum wage workers are guaranteed benefits equal to 120% of the poverty level. Another benefit for lower wage earners regards widow/widower benefits which will be increased to 75% of couple benefits versus 50%-67% today. The traditional benefit growth rate will begin to be indexed to inflation for those turning 62 in 2009 rather than indexed to wages. Besides these measures, there are no other changes to the benefit formula of traditional Social Security.

The plan results in solvency and a sustainable system

The commission reports that those who opt for the IIA should expect higher benefits than current retirees, retirees without accounts, and any beneficiary if no reform takes place. For example, a medium-earner choosing to establish an individual account and retiring in 2052 would receive benefits 59% higher than those paid to current beneficiaries. Furthermore, at the end of the seventy-five year valuation, the private account system is expected to hold $12.3 trillion dollars ($1.3 present value) much of which includes new savings.\textsuperscript{1xxiv}

There are other arguments against privatization to discuss such as the need for such drastic change, the benefits to the financial markets, and the loss of collective risk. A
critical argument that anyone would support even if in favor of the ideas is the money required to make this transition. It is a fact that temporary transfers will be needed from general revenues to keep the trust fund solvent from 2025-2054.\textsuperscript{1xxv}

Although he did not win the 2004 Presidential election, John Kerry’s plans and viewpoints could probably be used as a good representation of those who oppose privatization and what they suggest to address Social Security. John Kerry did not outline an exact plan, but he had promised not to raise Social Security taxes, raise the retirement age, cut benefits, or privatize Social Security.\textsuperscript{1xxvi} The three main aspects of his general plan included growing the economy to be in a better position to fund the system, restoring fiscal discipline and reducing the deficit, and solving the problem using a bipartisan process.\textsuperscript{1xxvii} Kerry confirmed he would raise taxes back to the rates under the Clinton Administration for those earning over two-hundred thousand dollars and would improve spending restraints on the budget.\textsuperscript{1xxviii} Kerry had recently also said there would be no tax increases for people earning less than two-hundred thousand dollars.\textsuperscript{1xxix} Unless he could suggest this referred only to income taxes or could compensate this group in some other way, this statement would have prevented Kerry from lifting the ceiling of $87,900 on earnings subject to the payroll tax.\textsuperscript{1xxx} I assume he would have used general increases in revenue from the return to prior tax rates and reduced government spending to transfer funds and remain solvent.

Kerry did not really propose a detailed plan but has debated the benefits of privatization. Kerry argued that Bush presented no plan to cover the cost of the diverted payments that are estimated to be one trillion dollars.\textsuperscript{1xxxi} To cover the costs, opponents say that the three possibilities include government borrowing, cuts to other government
programs, or higher taxes. Kerry argued that Bush’s plans will cut benefits up to 45% and increase the deficit by two trillion dollars. He also maintained that Bush is responsible for the budget crisis and is lacking in fiscal responsibility. Kerry contended that the tax cuts account for most of the long-term deficit, and that Bush ruined an opportunity to use the surplus to save Social Security. According to the independent Central Budgeting Office, they reported that 94% of the five hundred billion dollar deficit for 2005 was due to Bush’s excessive spending and ineffective tax refunds for the wealthiest.

Opponents argue that the Bush plan would only weaken Social Security, hurt the economy, and endanger many workers’ retirements by unnecessarily putting them at risk. Moreover, many legislators have questioned the “crisis” recently. Prior to the election Kerry called the situation a “manageable challenge” pointing out that when the trust fund is exhausted in 2042, at least 73% of the benefits can be currently paid. To fix Social Security, Kerry and others think they need to guarantee a basic level of financial security for the elderly and simultaneously close the current gap. Opponents to privatization also make other arguments. They say this plan involves overexposure to the stock market with an unjustified amount of risk. These people feel that those without a pension or savings do not belong in the stock market. Other concerns discussed include the issue of beneficiaries running out of money and losing inflation protection of the government benefits. On that note, some traditional advocates make a broader social argument against privatization. They say that everyone loses if all citizens do not have a secure retirement. Social Security takes the risk out of growing old and has really had remarkable results. Some feel privatization is only a front to an agenda of Bush and others with an anathema against taxation and income redistribution.
In regard to Kerry’s ideas to address the Social Security issue, the Bush administration made statements prior to the election countering the Senator’s assertions. The Bush administration argued that economic growth will not solve the problem.\textsuperscript{xiii} They maintain that if taxes and benefits are based on wages, faster economic growth would increase the benefits required along with the extra revenues from taxes.\textsuperscript{xiv} The Social Security Trustees report gives no support that economic growth would solve the problem.\textsuperscript{xv} In addition, the administration argues that more workers will not change the decreasing ratio of workers to retirees.\textsuperscript{xvi} Finally, the Bush administration attacked Kerry’s argument that fiscal discipline would allow the government to save money elsewhere and transfer it to Social Security. They argue that if spending increases on these entitlement programs, resources will be reduced for working families and children.\textsuperscript{xvii}

Since Bush’s win in the 2004 election and the recent promotion of his Social Security plan, other opponents to the plan have become vocal and have mobilized. Bush faces arguments from a wide variety of people including advocates for the disabled, senior citizens groups such as the AARP, and the AFL-CIO. These groups along with others have formed a coalition to counter the White House plan.\textsuperscript{xviii} Furthermore, Bush probably expected resistance from Democrats, but he also has not received much support from the Republicans in Congress. All of these varying individuals and groups are opposed to the plans and cite a variety of reasons.

The AARP began a vigorous campaign to fight the privatization plan in letters to its 35 million members.\textsuperscript{xix} Retiree Jack Heim said he was looking forward to telling senators his message which is, “Don’t destroy the greatest program in the world.” The CEO of AARP, Bill Novelli, maintains, “We are dead-set against carving private accounts out of
Social Security money.” He argues that there is no crisis, and the system only needs a slight adjustment. This feeling is behind their multimillion dollar campaign hoping to defeat Bush’s plan. Groups such as AARP have power as voters, a fact of which most Congress men and women are well aware. The President would have to convince members of Congress to enact changes that directly oppose an important constituency. AARP denies being an obstructionist, and officials from the organization are eager for a bipartisan solution that does not change the traditional system. Alternative suggestions of the group include raising the payroll tax, raising the amount of wages taxed, or increasing the retirement age.

Opponents in Congress hope to counter Bush’s arguments that the current system is unsustainable and hope to garner support against the solution of private accounts. Of the same opinion of the AARP, the late Representative Robert Matsui argued Social Security as a manageable problem. Matsui and others say the shortfall is a more manageable $3.7 trillion dollars. Democrats and other critics say that Bush is trying to scare Americans into supporting his plan. Democratic Party leaders in Congress issued a statement saying, “We cannot support any plan that relies on massive and irresponsible increases in debt.” In response to this concern of increasing debt, the President said he would pursue deficit reduction by placing spending controls in all areas unrelated to defense and homeland security. While Democrats have been vocal, other opponents argue that the administration’s lack of detail makes it hard for them to respond specifically but still anticipate required cuts in benefits and a further increased deficit. The administration so far has refused to discuss the financial tradeoffs that would be required to implement the system. Democrats and other critics say the approach would damage a stable benefit
system and give a huge government-subsidized windfall to Wall Street. Another group of constituents that will concern those in Congress are labor unions who echo these concerns about a gift to Wall Street. The AFL-CIO President, John Sweeney, said the Bush plan was a "risky scheme for America, but a sure bet for the financial services industry." He also said that the financial services industry should behave as professionals and speak truthfully about this issue to the investing public rather than once again trying to make money at the expense of customers. Financial companies countered that the fees would be minimal, and profits would not occur for several years.

In addition to this strong opposition, Bush is not receiving much support from his own party. An analyst at the conservative Heritage Foundation said most in Congress oppose reform or remain unconvinced. Some key Republicans have spoken out without much enthusiasm. Some questioned the idea that the system was in crisis echoing the sentiments of Democrats and constituents and said new taxes should be considered. House Ways and Means Committee Chairman, Bill Thomas, suggested a value-added tax and others changes. Thomas is one of the most prominent voices on tax policy and said payroll tax or retirement age changes are not permanent solutions. Thomas suggested the money could come from value-added tax on imports like those used in some nations of Europe. On the other hand, Senator John McCain said a payroll tax increase must be an option. Senator Olympia Snowe complained that so far the discussion has only created fear and misunderstanding.

Using more objective criteria to study the issue is helpful in comparing privatization and the traditional system along different elements. Both sides of the issue argue their plans to be certain, convenient, equitable, and economical. These criteria can
be difficult to decide since the intent of both is to provide these criteria while the results of
the two plans cannot definitely be known. President Bush argues his plan is more
sufficient and certain because it allows younger workers to get better rates of return, allows
all workers to have the security of ownership, and gives all workers the opportunity to
build wealth and pass it on to heirs. According to the Commission, personal accounts
would grow rapidly because of the impact of compound interest. Opponents argue that
this plan weakens the certainty of Social Security by putting workers at risk in the stock
market and does nothing to solve the current problem regarding sufficiency of payments
now or in the future. Others worry about beneficiaries outliving the payments and the
loss of traditional payments that are adjusted for inflation.

The plan proposed by the President is suggested to be efficient and convenient. The
Commission cites the Thrift Savings Plan used for some federal employees as an
exemplary model in which a convenient plan has brought the participants substantial
returns. Under government supervision, employees in this plan are allowed to have
information about their assets, the right to diversity, and are allowed only the choice of
reliable investments. Assuming that opponents would maintain traditional Social
Security, it would be as convenient as it is currently. Therefore, Bush’s plan must be
called somewhat less convenient since it involves two systems.

Vertical equity implies that those who are not equally situated should be taxed
differently. Assuming that the Bush plan maintains the current payroll tax rate but diverts
a portion (four percent possibly) to the voluntary accounts, the proportion of Social
Security tax paid remains the same. This tax is still regressive though due to the ceiling
limitations. In addition, although it may work wonderfully, currently there is no definite
proof and for those who have no other retirement to fall back on, it may be unfair to allow them to be at such a risk. President Bush and other advocates believe the plan contributes to vertical equity by aiding disadvantaged groups such as divorcees, women, minorities with shorter life spans, and those without savings. On the other hand, opponents’ ideas also rely on vertical equity. Opponents of privatization argue that traditional Social Security takes the financial risk out of growing old and broadly pools the risks to protect everyone. These opponents believe that the Bush plan is a way to force an “every man for himself” situation.

Horizontal equity implies that those similarly situated should be treated equally. Privatization would require the same percentage of payroll taxes from people in low incomes and approximately the same percentage of those situated with high incomes. The traditional Social Security system also is supported by horizontal equity. The personal accounts; however, may not bring the same returns or may put those afraid to invest at a disadvantage. Assuming neither side would cut benefits, equity is maintained by generation so retirees do not pay more taxes and receive reduced benefits.

The Commission has determined that administration can be efficient and cost effective and refer to the Thrift Savings Plan and its modest cost. Traditional Social Security administrative expenses were only 0.6% of total expenses of OASI and 2.7% of totals for DI in 2003. These findings appear to be equal, although any new system would require costs to start and transition since essentially there would be two systems for several years.

To determine an opinion on this matter is very difficult. Of course, everyone wants to support the plan where benefits are not cut, younger generations’ retirements are not at
risk, and the vulnerable are protected. Both Bush and opponents of privatization argue that their ideas accomplish this while the other side is mistaken and will do the opposite. This stems from opposing beliefs on privatization and a traditional system. Assuming Democrats and other critics think they could deliver on fiscal discipline and the budget crisis, they would actually be in a better position than Bush to fund the trillion dollar hole caused by the transition. Opponents such as Kerry are against privatization for other reasons. They argue that the system is intended to be a pooling of risks to ensure secure retirement for all.\textsuperscript{exx} Privatization may seem harsh and even competitive, certainly not its intent.

Although a lot of the arguments are opinion and whose promises one wants to believe, I think that privatization is not as strong as the traditional system on certainty or convenience. Equity is more difficult to determine, and possibly privatization would be more equitable, but there is no guarantee this can be successful. Economy has been proven to not really be a substantial issue. I do think that even if privatization may have some complications, it is worth undertaking a change if it promotes a positive future. Although it may be difficult, it is certainly imperative to change if more beneficial to the future. I do admit maintaining a system for tradition's sake is not a good idea if rational analysis leads to an improved system.

It is interesting to think about this situation from a perspective of different age groups. Again, it is still a difficult task because agreeing with one viewpoint would probably lead one to disagree with the other. In addition, a political issue such as this one can influence us by its supporters that we admire rather than concentrating on the hard facts. Different age levels have differing concerns and possibilities. For example, a
twenty year old American who does not believe that traditional Social Security can be repaired would be in favor of a new plan such as privatization. Believing that your current taxes are paying for the current retirees, but the same benefit will not be available for you in the future would be frustrating. In this situation, most twenty year olds would probably support making this change for their own benefit as well as for their family. With that said, a twenty year old would not want to support something that would leave today’s seniors or soon-to-be seniors without their Social Security. All generations deserve respect and consideration involving a solution to the Social Security problem. Likewise, a twenty year old who believed that the Social Security problem was minor, felt the original system a strong one, or did not trust the promises of privatization would not support a change. Although this analysis sounds very ambiguous, it is really impossible to be sure what will happen in the future. With that said; however, uncertainty certainly does not permit apathy.

As a forty year old American, their timing in reaching retirement closely coincides with the key exhaustion dates so this age group is very interesting to examine. In this age group, a forty year old would not be able to receive full benefits according to the current projections if nothing is done. Also, this age bracket does not have the time which the younger generations have to receive the benefit that time provides to amass as much wealth in a private account. Again, it is really a choice between beliefs in the future and what one feels will happen. Assuming a forty year old felt the traditional system could be repaired, I would assume many in this age group would feel more secure with the traditional system. They have worked several years believing in it, and they will not have the time span to see all the benefits of private accounts that have been promised. A forty year old who is
confident that private accounts will work and the shortfalls will be met would likely be interested in privatization. If in favor of private accounts, this age group has a vested interest in being able to save since they will not be fully funded as the situation now stands. At the age of forty, a worker would have many years to save into their private account so likely would want a solution implemented as soon as possible.

The perspective of a sixty year old is very important to contemplate. The AARP has come out strongly against Bush’s plan for private accounts. The AARP is a very prominent and influential organization. It has approximately thirty-five million members, and these Americans are important voters to whom politicians pay close attention. A plan opposed by the AARP will have much more difficulty in attempts to pass legislation. Seniors such as those about sixty years old will retire soon and receive their benefits that will be paid by the current taxpayers. Most of the current AARP membership will live in a time period before insolvency. These men and women worked and paid taxes in the past and want to receive benefits in the future. Most are probably against privatization because the plan defers some of their benefits into current workers’ private accounts. Without any definite plan to amend this situation, it is understandable that seniors would be concerned. Again, the argument returns to the solutions offered and really individuals’ ideological beliefs and confidence in the government to find a remedy. If a sixty year old feels that privatization is a good idea and beneficial to future generations and the future of Social Security, they would support it if a solution for the shortfall is found. On the other hand, a sixty year old that believes in the strength of the traditional system and believes private accounts pose significant risks and problems would oppose a change.
For any age group, I think the decision to support traditional Social Security or President Bush’s private account plan is really based on personal opinion and ideological stances that may be held. The evidence does not really clearly point in the absolute correct direction with a definitive right and wrong. Both say the other will not work while their plan will work. Based on the evidence, one must make an educated decision on which plan has the most merit for themselves and for retirees of the present and future.

I certainly do not think either those in favor or against privatization want to cause a crisis in Social Security both for moral reasons and their own self-image. I think privatization sounds like it has many benefits possibly new benefits that traditional Social Security does not allow. I hope I have examined from both perspectives. Based on the information, I support adhering to the traditional system. If there is not plan for the transition costs and if even one person is at risk, Social Security is too serious to risk for our elderly and future generations. I think the reason it is most difficult is the unknown future regarding if privatization will work or the federal budget can be adjusted to fix the original. I think both sides should be willing to be honest with the American people that their plan is their best proposal and may need adjusting at times to ensure a secure retirement system.
"The Consequences of John Kerry Not Having a Plan for Social Security"


Report of the President’s Commission


"Bush: Social Security Plan Has Safeguards”

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“A Plan to Protect and Strengthen Medicare and Social Security”


“Kerry puts on the Straight Jacket”

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“How Not to Save Social Security”

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"Bush Vows to Convince Congress on Social Security"

"Bush: Social Security Plan has Safeguards"

"How Not to Save Social Security"

"Specifics on The President's Plan to Strengthen Retirement Security"

"How Not to Save Social Security"