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Recommended Citation

Kathryn L. Moore, *Social Security Reform in 2005 and Beyond*, *New York University Review of Employee Benefits and Compensation* 2006 (Alvin D. Lurie, ed.), Chapter 8

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Notes/Citation Information

New York University Review of Employee Benefits and Compensation 2006 (Alvin D. Lurie, ed.), Chapter 8

CHAPTER 8

Social Security Reform in 2005 and Beyond

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SYNOPSIS

- § 8.01 Introduction
- § 8.02 Principal Reform Proposals
 - [1] President Bush’s “Personal Retirement Accounts”
 - [2] Robert Pozen’s Progressive Price Indexing Plan
 - [a] Calculating Benefits Under the Current Social Security System
 - [b] Price Indexing Versus Wage Indexing
 - [c] Progressive Price Indexing
 - [d] Costs and Benefits of Progressive Price Indexing
 - [3] Proposal to Fund Personal Retirement Accounts with Social Security’s Annual Surpluses
- § 8.03 Why Social Security Reform Failed in 2005
- § 8.04 Future Prospects for Social Security Reform

§ 8.01 INTRODUCTION

Social Security reform started with a bang in 2005. President Bush placed it at the top of his domestic agenda¹ and featured it prominently in his 2005 State of the Union Address.² The President

¹ Cf. Edwin Chen and Joel Havemann, *Social Security plan withering, Bush says: Cites more urgent needs of Gulf area*, Lexington Herald-Leader A-8 (Oct. 5, 2005) (noting that restructuring Social Security was once Bush’s top second-term domestic priority).

² See “*We Must Pass Reforms that Solve the Financial Problems of Social Security*,” New York Times A22 (Feb. 3, 2005) (transcript of President Bush’s State of the Union address as recorded by the New York Times).

spent the early months of the year on a “60-day, 60 city tour” of the country touting his pet project, amending Social Security to create “personal retirement accounts.”³ Indeed, there was so much activity in the arena that the BNA Pension and Benefits Reporter frequently devoted a separate section to Social Security news in 2005.⁴

Despite its early prominence, Social Security reform ended with a whimper by the end of 2005. By October, President Bush acknowledged at a news conference that his proposed Social Security overhaul was going nowhere. “There seems to be a diminished appetite in the short term, but I’m going to remind people that there is a long-term issue that we must solve,” he said.⁵

What happened to this hot button issue in 2005? This Article begins by describing and analyzing three of the most politically salient reform proposals in 2005. It then explains why Social Security reform failed despite President Bush’s Herculean effort to partially privatize the system.⁶ Finally, it concludes by discussing the prospects for reform in 2006 and beyond.

³ See William Douglas, et al., *Bush’s second-term blues: The President’s aggressive agenda is bogged down*, Phila. Inquirer A01 (April 25, 2005) (“Unable to convince Americans that Social Security was in crisis, White House officials embarked on a 60-day, 60-city tour to explain the situation and tout Bush’s proposal for private investments.”); Glen Johnson, *Democrats shift aim to savings proposals; After denouncing Bush plan, lawmakers want to give an alternative*, Charlotte Observer 9A (April 26, 2005) (“The Democratic shift also comes as Bush winds down a 60-day, 60-city tour aimed at building support for his proposal, a drive he kicked off on March 3.”).

⁴ See, e.g., 32 BNA Pens. & Bene. Rptr. No. 30 (Aug. 2, 2005); 32 BNA Pens. & Bene. Rptr. No. 28 (July 19, 2005); 32 BNA Pens. & Bene. Rptr. No. 26 (July 5, 2005).

⁵ Alex Wayne and Martha Angle, *Bush sees less appetite for Social Security Overhaul; Lawmakers point to Menu*, Congressional Quarterly Today 12 (Oct. 4, 2005).

⁶ Of course, President Bush never referred to his proposal as “partial privatization” of Social Security. The term “partial privatization” came out of political favor in the late 1990s, but the substance of President Bush’s proposal was identical to what used to be referred to as “partial privatization.” See Kathryn L. Moore, *President Bush’s Personal Retirement Accounts: Saving or Dismantling Social Security?*, NYU Rev. Of Employee Benefits and Executive Compensation 5-1, 5-24 nn. 113-15 (2005), and accompanying text.

§ 8.02 PRINCIPAL REFORM PROPOSALS

[1] President Bush's "Personal Retirement Accounts"

The first, and most prominent, reform proposal in 2005 was President Bush's proposal to create "personal retirement accounts." It was featured prominently in his 2005 State of the Union Address, and he spent the early months of the year traveling throughout the country to promote his proposal. Indeed, as late as July 2005, he was adamant that any Social Security reform include individual accounts.⁷

In *Strengthening Social Security for the 21st Century*,⁸ a document posted on the White House website in February 2005, President Bush proposed that workers be permitted the option of gradually investing up to 4 percentage points of their Social Security payroll taxes into individual accounts.⁹ Contributions would be capped at \$1,000 in 2009, and increase by \$100 plus wage inflation each year, until they reached 4 percent of taxable wages by 2041.¹⁰ Beginning in 2009, workers born between 1950 and 1965 would be permitted to contribute to the accounts, and by 2011, all workers born before 1950 would be eligible to contribute to the accounts.¹¹ Unless a worker and his or her spouse elected otherwise, once a worker reached 47, the worker's account would be invested in a "life cycle portfolio;" that is, a portfolio which would gradually and automatically reduce the percentage of the portfolio invested in

⁷ See also Elizabeth White and Heather M. Rothman, *Thomas Floats Ideas for Making Annuities More Flexible, Attractive Planning Vehicles*, BNA Pens. & Bene. Rptr. 1369, 1369 (June 21, 2005) (On June 14, President Bush said, "I'm going to continue working this issue, state after state. I'm going to continue to call upon the United States Congress, members of both political parties, to stand up, to do what's right for a young generation of Americans coming up, to fix this Social Security system once and for all.").

⁸ *Strengthening Social Security for the 21st Century* 5 (Feb. 2005), available at www.whitehouse.gov/infocus/social-security/200501/strengthening-socialsecurity.html.

⁹ *Id.*

¹⁰ *Id.* The President's proposal does not state when the permissible contributions would reach 4 percentage points, but an analysis of the proposal by the Center on Budget and Policy Priorities states that they would reach that level by 2041. Jason Furman, *The Impact of the President's Proposal on Social Security Solvency and the Budget* 5 (July 22, 2005), available at www.cbpp.org/5-10-05socsec.htm.

¹¹ *Strengthening Social Security for the 21st Century*, *supra* note 8, at 8.

stocks as the worker ages.¹² Workers who elected to contribute to individual accounts would have their traditional Social Security benefits reduced by their contributions to the account plus an interest rate charge equal to 2.7 percent above the inflation rate.¹³

In introducing the proposal, President Bush offers three justifications for the accounts: (1) they would “provide ownership and control;” (2) they “could be passed on to children and grandchildren;” and (3) they would “give younger workers the chance to receive a higher rate of return” than is available under the current system.¹⁴

Undoubtedly, President Bush’s proposal would “provide ownership and control” and thus advance President Bush’s drive for an ownership society.¹⁵ Providing ownership and control, however, is not one of the goals of the current Social Security system.¹⁶ Rather, as I explained in my contribution to the 2005 edition of this Review, the current Social Security system is a system of social

¹² *Id.* The Vanguard Total Retirement 2045 Fund is an example of a life cycle account. As the name suggests, it is targeted toward an individual retiring in 2045. Initially, the fund invests almost completely in stocks, but is designed to gradually and automatically shift to almost all bonds by 2045. Andrew J. Rettenmaier and Zijun Wang, *Social Security Reform: Responding to the Critics*, National Center for Policy Analysis Report No. 281, at n.5 (Nov. 2005), available at www.ncpa.org/pub/st/st281.

¹³ The President’s ten page proposal designed for public consumption does not mention the offset. *Strengthening Social Security for the 21st Century*, *supra* note 8, at 8 (Feb. 2005). A study by the Center on Budget and Policy Priorities, however, notes that the offset rate was originally set at 3.0 percent above the inflation rate but later was reduced to 2.7 percent. Furman, *supra* note 10, at 5.

¹⁴ *Strengthening Social Security for the 21st Century*, *supra* note 8, at 5.

¹⁵ Grover Norquist, a Republican party strategist and president of the Americans for Tax Reform, contends that creating individual accounts would “‘permanently create a Republican majority’ by increasing the size of the investor class from roughly 60 percent of the U.S. population to 100 percent.” *Senate Finance Panel Plans Hearing As GOP Strategizes to Engage Democrats*, 32 BNA Pens. & Bene. Rptr. 829, 830 (April 12, 2005).

¹⁶ Of course, critics of the current system, such as the Cato Institute, contend that “the real problem [with the current system] is that Americans have no ownership rights to their benefits,” and that the current system should be amended to promote ownership and control. *New Cato Radio Advertisements Aim To Shift Gears in Debate Over Accounts*, 32 BNA Pens. & Bene. Rptr. 834, 834 (April 12, 2005) (discussing Cato Institute’s radio ad campaign in favor of private accounts).

insurance whose essential purpose “is to prevent hardship, poverty, or dependence that might be caused by contingencies covered wherever and whenever these might occur among workers able to join their employers and the government in a national program.”¹⁷ Amending Social Security to provide ownership and control would not strengthen the current system; rather it would fundamentally restructure the system as the first step toward dismantling it.¹⁸

In many ways, President Bush’s second justification for his personal retirement accounts, that “they could be passed on to children and grandchildren,” is closely related to his first justification, that they would “provide ownership and control.” Indeed, the Cato Institute, a staunch critic of the current Social Security system and proponent of individual accounts, has argued that the Social Security debate “should be about ownership and inheritability of retirement assets,” rather than solvency.¹⁹

As a social insurance system, the current Social Security system does not create inheritable wealth. This is not to suggest, however, that the system does not provide any protection for the survivors of deceased workers. Since 1939,²⁰ the American Social Security system has provided benefits for the surviving spouses,²¹ dependent children,²² and dependent parents²³ of deceased workers. Indeed, in December 2004, over 6.5 million individuals received Social Security benefits as the surviving spouse,²⁴ dependent child,²⁵ or

¹⁷ Moore, *supra* note 6, at 5-23, quoting J. Douglas Brown, *Essays on Social Security* 57-58 (1977).

¹⁸ *Id.* at 5-22-5-25. See also Paul Krugman, *Social Security Lessons*, NY Times (Aug. 15, 2005) (“In fact, Mr. Bush came to bury Social Security. Over time, the Bush plan would have transformed Social Security from a social insurance program into a mutual fund, with nothing except a name in common with the system F.D.R. created.”).

¹⁹ *New Cato Radio Advertisements Aim To Shift Gears in Debate Over Accounts*, 32 BNA Pens. & Bene. Rptr. 834, 834 (April 12, 2005) (discussing Cato Institute’s radio ad campaign in favor of private accounts).

²⁰ See Social Security Act Amendments of 1939, Pub. L. No. 76-379, Secs. 202(c)-(f), 53 Stat. 1360, 1362-66 (1939).

²¹ 42 U.S.C. Secs. 402(e)-(g).

²² 42 U.S.C. Sec. 402(d).

²³ 42 U.S.C. Sec. 402(h).

²⁴ Over 4.5 million of the beneficiaries were surviving spouses. Social Security Administration, Annual Statistical Supplement Table 5.A1 (2005) (noting that there

dependent parent²⁶ of a deceased worker.²⁷ Generally, surviving spouses are entitled to a benefit equal to 100 percent of the deceased worker's benefit,²⁸ while surviving children are entitled to a benefit equal to 75 percent of the deceased worker's benefit,²⁹ and surviving parents are entitled to a benefit equal to 82 1/2 percent of the deceased worker's benefit.³⁰ In December 2004, the average survivors' benefit was \$820, with nondisabled surviving spouses receiving an average benefit of \$920,³¹ surviving children receiving an average benefit of \$625, and surviving parents receiving an average benefit of \$830.³²

President Bush claims that “[p]ermitting individuals to pass on their retirement accounts to loved ones [may be] particularly beneficial to widows, widowers, and other survivors.”³³ It is not clear, however, that amending the Social Security system to create inheritable personal accounts would result in survivors receiving greater benefits than they would receive under the current Social Security system. President Bush's proposal would reduce the traditional Social Security benefits of workers who elect to defer contributions to personal accounts by their contributions to the account plus an interest rate charge equal to 2.7 percent above the inflation rate.³⁴ Assuming survivor benefits would also be subject to this benefit offset,³⁵ it is far from certain that survivors would

were 4,431,020 nondisabled widow(ers), 209,700 disabled widow(ers), and 182,900 widowed mothers and fathers in December 2004).

²⁵ Over 1.9 million of the beneficiaries were surviving dependent children. *Id.*

²⁶ Only 2,030 of the beneficiaries were surviving dependent parents. *Id.*

²⁷ *Id.*

²⁸ 42 U.S.C. Secs. 402(e)(2)(A), 402(f)(3)(A). The benefit for a surviving spouse of deceased workers under the age of 60 and caring for the deceased worker's eligible children is generally equal to 75 percent of the deceased worker's benefit. 42 U.S.C. Sec. 402(g)(2).

²⁹ 42 U.S.C. Sec. 402(d)(2).

³⁰ 42 U.S.C. Sec. 402(h)(2)(A).

³¹ Disabled surviving spouses received an average benefit of \$582, and widowed mothers and fathers (that is, surviving spouses of deceased workers under the age of 60 and caring for the deceased worker's eligible children) received an average benefit of \$687. Social Security Administration, *supra* note 24, at Table 5.A1.

³² *Id.*

³³ Strengthening Social Security for the 21st Century, *supra* note 8, at 5.

³⁴ *See* note 13, *supra*.

³⁵ It is not clear whether the benefit offset would apply to survivors' benefits

inherit sufficient benefits from workers' retirement accounts to make up for the benefit offset.

In *Strengthening Social Security for the 21st Century*, the President declares that “according to the non-partisan analysis by the Social Security Administration’s Office of Retirement Policy, the ability to inherit personal accounts provides the largest gains to widows and other survivors.”³⁶ He does not, however, cite a specific study, and I am not aware of any study by the Social Security Administration or anyone else that clearly establishes that surviving spouses, children, and parents would be better off under a system of individual accounts than under the current Social Security system.³⁷ Indeed, as a comprehensive study of individual accounts by the National Academy of Social Insurance notes, “Amid all the work on creating individual Social Security accounts for retirees, policymakers have paid less attention to individuals whose eligibility for Social Security benefits is based on family relationships or disability.”³⁸

Finally, although personal accounts might “give younger workers the chance to receive a higher rate of return” than is available under the current system,³⁹ as I explained in my contribution to the 2005 edition of this Review, (1) it is not appropriate to compare rates

under President Bush’s plan. See William E. Spriggs, *Children Get Social Security, Too*, 14 *Poverty & Race* 1, 2 (No. 2 March/April 2005) (“[U]nder the Bush plan, the private accounts are a loan against the worker’s retirement benefit, which must be paid out of the Social Security retirement benefit with interest, calculated at 3% above inflation — last year, 6.2% interest. It is unclear whether the loan would have to be repaid out of survivor or disability benefits.”). It would, of course, be possible to structure the plan so that survivors’ benefits were not subject to the offset. Cf. National Academy of Social Insurance, *Uncharted Waters: Paying Benefits From Individual Accounts in Federal Retirement Policy* 160 (2005) (noting that it would be possible to calculate benefits for young survivor families differently than from the method used to calculate benefits for retirees to shield young survivor families from benefit reductions).

³⁶ *Strengthening Social Security for the 21st Century*, *supra* note 8, at 5.

³⁷ Cf. Spriggs, *supra* note 35, at 11 (“The benefits of children are greatly threatened by changing the focus of the program — from assuring American parents that their children will be protected from economic calamity if the parent becomes disabled, dies or lives long enough to avoid being a burden on their children — to being solely an individual savings vehicle for retirement.”).

³⁸ National Academy of Social Insurance, *supra* note 35, at 117.

³⁹ *Strengthening Social Security*, *supra* note 8, at 5.

of return under the current system with rates of return on equity investments,⁴⁰ (2) personal accounts would not guarantee younger workers a higher rate of return,⁴¹ and (3) investing Social Security contributions in the private equities market does not require the creation of personal accounts.⁴²

[2] Robert Pozen's Progressive Price Indexing Plan

A second Social Security reform proposal to receive considerable attention in 2005 was a “progressive price indexing” proposal introduced by Robert Pozen, an investment executive and member of President Bush’s 2001 Commission to Strengthen Social Security.⁴³ President Bush has endorsed the proposal.⁴⁴

Under this proposal, initial benefits for low-wage workers would be wage indexed while benefits for high-wage workers would be

⁴⁰ See also Jason Furman, *Would Private Accounts Provide a Higher Rate of Return Than Social Security* (June 2, 2005), available at www.cbpp.org/6-02-05htm (explaining why rates of return under Social Security should not be compared with rates of return in private capital markets).

⁴¹ In March 2005, Yale economist Robert Shiller released a study of private accounts invested in life cycle portfolios. Using actual historical stock returns dating back to 1871, Shiller found that 32 percent of the time a life cycle portfolio would produce returns below the 3.0 percent then assumed for the benefit offset. In addition, using a lower rate of return to reflect reduced expectations about future returns, Shiller found that 71 percent of the life cycle portfolios would fall below the then-proposed 3.0 percent break-even point. Robert Shiller, *The Life-Cycle Personal Accounts Proposal for Social Security: An Evaluation* (March 2005), available at www.irrationlaexuberance.com/ShillerSocSec.doc.

⁴² Moore, *supra* note 6, at 5-11-5-20.

⁴³ Pozen’s progressive price indexing plan is part of a broader proposal that includes individual investment accounts. Stephen C. Goss, *Estimated Financial Effects of a Comprehensive Social Security Reform Proposal Including Progressive Price Indexing — INFORMATION*, Social Security Administration Memorandum to Bob Pozen 2 (Feb. 10, 2005), available at www.ssa.gov/OACT/solvency/RPozen_20050210.pdf (describing Pozen plan). The plan, however, can stand on its own and need not be linked with private accounts. See Statement of Robert C. Pozen, Chairman, MFS Investment Management, Boston, Mass., Hearings on Alternatives to Strengthen Social Security, Hearing Before the House Ways and Means Committee, Serial 109-22, 109th Cong., 1st Sess. (May 12, 2005), available at waysandmeans.house.gov/hearings.asp?formmode=view&id=3203.

⁴⁴ Elizabeth White, *Bush Again Calls for Private Accounts, Endorses “Progressive Price Indexing,”* 32 BNA Pens. & Bene. Rptr. 1008, 1008 (May 3, 2005) (noting that Bush endorsed progressive price indexing in “a nationally televised news conference” on April 28, 2005).

price indexed and benefits for average-wage workers would be partially wage-indexed and partially price indexed. The proposal has the potential to reduce significantly Social Security's long-term funding deficit.⁴⁵ Moreover, the proposal would protect the benefits of low-wage workers.⁴⁶ Of course, the proposal would not be costless. It would reduce the benefits of high-wage and average-wage workers, and if retained for a long enough period of time, could effectively eliminate Social Security's progressive benefit formula and result in all workers receiving the same level of benefits.⁴⁷

[a] *Calculating Benefits Under the Current Social Security System*

The current Social Security system uses a method of wage-indexing to calculate initial benefits. Specifically, earnings are indexed by multiplying each year's wage by an indexing factor equal to the ratio of the average national wage in the year the worker turns 60 to the average national wage in the year to be indexed.⁴⁸ For administrative ease, wages earned at age 60 or later are left at their nominal values in the indexing process.⁴⁹ Average adjusted earnings, or "average indexed monthly earnings" ("AIME"), are then calculated by taking the best 35 years of earnings adjusted for past wage inflation, adding them together and dividing them by 420 (the number of months in 35 years).⁵⁰

⁴⁵ See n. 80 *infra* and accompanying text.

⁴⁶ Alicia Munnell and Mauricio Soto, *What is Progressive Price Indexing?*, Boston College Center for Retirement Research Just the Facts on Retirement Issues 4 (No. 17 April 2005) ("Progressive price indexing has the advantage of protecting the benefits of low earnings workers. These workers would be assured of receiving the same amount relative to previous earnings as they do today.").

⁴⁷ Patrick Purcell, "Progressive Price Indexing" of Social Security Benefits, Congressional Research Service Memorandum CRS-10 (April 22, 2005) ("Under the method of progressive price indexing analyzed by SSA and described in this memorandum, all workers eventually would be paid the same monthly benefit. . . . CRS estimates that this would occur approximately 100 years following the implementation of progressive price indexing as described by SSA, assuming long-run real wage growth of 1.1% per year.").

⁴⁸ 42 U.S.C. Sec. 415(b)(3).

⁴⁹ "Earnings are indexed only up to age 60 because it can take up to two years for the national earnings data on which the wage indexing series is based to become available." Purcell, *supra* note 47, at 2 n.4.

⁵⁰ 42 U.S.C. Sec. 415(b)(1).

Average adjusted earnings are then multiplied by a progressive benefit formula to determine the worker's primary insurance amount (PIA).⁵¹ The formula replaces a higher percentage of average adjusted earnings with the lower one's average earnings so that the ratio of benefits to average earnings is higher for those with low average earnings than for those with high average earnings. The benefit percentages (90%, 32%, and 15%) remain the same each year,⁵² while the dollar amounts, or "bend points,"⁵³ are increased by the rate of growth of the national average wage.⁵⁴ For those reaching age 62 in 2006, the formula replaces 90 percent of the first \$656 of AIME, plus 32 percent of AIME between \$656 and \$3,955, plus 15 percent of AIME above \$3,779.⁵⁵

By indexing earnings and adjusting the bend points each year for increases in the national average wage, the current Social Security system ensures that benefits for each generation of workers grow at the same rate as their wages grow, and the replacement rate, that is, initial benefits as a percentage of workers' career-average earnings, remains constant.⁵⁶ The Social Security Administration has estimated the replacement rate for low-wage workers to be 55 percent, for average-wage workers to be 41 percent, and for high-wage workers who have always earned the annual maximum taxable wage to be 27 percent.⁵⁷

Once initial benefits are calculated, they are adjusted for increases in the consumer price index; that is, they are price indexed.⁵⁸ Price

⁵¹ 42 U.S.C. Sec. 415(a).

⁵² 42 U.S.C. Sec. 415(a)(1)(A).

⁵³ "The amounts at which the PIA factors change are called *bend points* because when the PIA factors are graphed against the AIME, the graph appears as three lines joined at these points." Purcell, *supra* note 47, at CRS-3 n. 5.

⁵⁴ 42 U.S.C. Sec. 415(a)(1)(B)(ii).

⁵⁵ 70 Fed. Reg. 61677 (Oct. 25, 2005) (establishing bend points for 2006).

⁵⁶ See Purcell, *supra* note 47, at CRS-2 ("Under current law, benefits for each generation of workers grow at the same rate as their wages grow. Consequently, (1) the *purchasing power* of benefits rises from one generation of workers to the next, and (2) the *replacement rate* — initial benefits as a percentage of workers' career-average earnings — remains constant for each successive generation of workers.").

⁵⁷ *Id.* at CRS-4–CRS-5.

⁵⁸ 42 U.S.C. Sec. 415(i).

indexing ensures that initial benefits do not decline in value as prices increase over time and that the retiree's buying power remains the same.⁵⁹

[b] *Price Indexing Versus Wage Indexing*

In 2001, President Bush's Commission to Strengthen Social Security proposed three alternative plans for reforming Social Security.⁶⁰ Model 2, the model considered the most likely to resolve permanently Social Security's funding deficit, included, among other changes, a shift from wage indexing to price indexing.⁶¹ Specifically, Model 2 proposed that, beginning in 2009, each year the PIA factors (90%, 32%, and 15%) be multiplied by the ratio of the Consumer Price Index (CPI) to the Average Wage Index in successive years while earnings and the bend points remain indexed for wage growth.⁶² Due to increases in worker productivity, wages tend to rise faster than prices, and price indexing is expected to cause the PIA factors to decrease and the Social Security replacement rates to fall over time.⁶³

To illustrate, suppose that in one year prices grow by 2.8 percent while wages grow by 3.9 percent, the long-term rates of growth projected by the Social Security Administration.⁶⁴ Based on these figures, each of the PIA factors would be multiplied by 1.028/1.039 or .989 that year. Assuming the Social Security Administration's

⁵⁹ Purcell, *supra* note 47, at CRS-1 ("Once enrolled in the program, beneficiaries' Social Security checks increase each year at the same rate as the Consumer Price Index (CPI) so that they do not decline in value as prices rise over time; i.e., they are *price indexed*."); Social Security Reform: Changes to the Benefit Formula and Taxation of Benefits, Am. Acad. of Actuaries, Issue Brief 3 (Oct. 2005) ("Indexing benefits to changes in the CPI helps ensure that the buying power of Social Security benefits remains the same after a worker begins receiving benefits.").

⁶⁰ President's Comm'n to Strengthen Soc. Sec., *Strengthening Social Security and Creating Personal Wealth for All Americans* (Dec. 21, 2001).

⁶¹ *Id.* at 119.

⁶² *Id.* at 120 n.39. For a discussion of alternative price indexing models and their effect on benefits and solvency of the Social Security system, see Andrew G. Biggs, et al., *Alternative Methods of Price Indexing Social Security: Implications for Benefits and System Financing*, NBER Working Paper No. 11406 (June 2005).

⁶³ Purcell, *supra* note 47, at CRS-6.

⁶⁴ See Board of Trustees of Fed. Old Age and Survivors Ins. and Disa. Tr. Funds, 2006 Annual Report 85, 86 (intermediate assumptions).

projections are accurate and the long-term rate of price growth is 2.8 percent and wage growth is 3.9 percent, after 75 years of multiplying the PIA factors by this ratio of price growth to wage growth, the factors would fall from 90 percent, 32 percent and 15 percent to 40.5 percent, 14.4 percent, and 6.7 percent respectively.⁶⁵ Moreover, all three PIA factors would continue to fall into the indefinite future.⁶⁶ Based on these projections, the replacement rate for an average-wage earner would fall from 39 percent under current law to 16 percent in 2080 under a price indexed system.⁶⁷

Because price indexing would decrease benefits so drastically, it is expected to more than resolve solvency to the Social Security system. Specifically, the Social Security Administration projects that price indexing benefits would cut benefits by 2.07 percent of taxable payroll⁶⁸ while the current projected shortfall is only 2.02 percent of taxable payroll.⁶⁹

[c] *Progressive Price Indexing*

Recognizing that over time price indexing could substantially reduce benefits and have a particularly adverse effect on low-income workers,⁷⁰ Robert Pozen proposed a progressive price

⁶⁵ Purcell, *supra* note 47, at CRS-6.

⁶⁶ *Id.*

⁶⁷ *Id.* The replacement rate for an average-wage earner is expected to fall from 42% today to 39% in 2080 because the normal retirement age is scheduled to increase from 66 to 67 under current law. *Id.*

⁶⁸ *Id.*

⁶⁹ Board of Trustees of Fed. Old Age and Survivors Ins. and Disa. Tr. Funds, 2006 Annual Report 2.

⁷⁰ In testimony before the Ways and Means Committee, Pozen described the rationale for his proposal as follows:

I believe that when Social Security was passed, there were no Individual Retirement Accounts (IRA) or 401(k)s; there weren't really even very many defined benefit plans. Now, in 2004 alone, the tax revenue foregone for IRAs and 401(k)s was roughly \$55 billion; if we include all private retirement programs, it was \$100 billion in that year alone. Most of those tax subsidies go to high-wage and to some degree middle-wage workers, and so, I believe in order to create neutral government support among wage groups, we need to do more for low-wage workers in Social Security. Very few of them have retirement programs like 401(k)s or IRAs and they are totally dependent on Social Security.

Statement of Robert C. Pozen, *supra* note 43.

indexing plan that would be effective for all those becoming eligible for benefits in 2012 or later.⁷¹ This plan would be implemented through a three step process. The first step would be to compute the percentage benefit reduction that would apply for a worker who had earned the maximum taxable wage throughout the worker's career if all three of the PIA factors (90%, 32%, and 15%) were fully price indexed.⁷² Next, a new "bend point" in the Social Security PIA formula would be created for low-wage workers, which would be defined as workers with career earnings at or below the 30th percentile of earnings, and benefits at or below this new bend point would continue to be wage indexed.⁷³ Finally, the third step of the process would be to calculate the percentage reduction to the PIA factors above the new bend point (32% and 15%) that would result in the same benefit reduction for workers who earned the maximum taxable wage throughout their career as would have applied if price indexing had applied to all workers.⁷⁴

Application of this three step process would result in reducing benefits for workers who have earned the maximum taxable wage base throughout their careers by the same percentage as they would have been reduced if the benefit formula were fully price indexed for all workers at all earnings level.⁷⁵ It would reduce benefits by a smaller percentage for workers who have earned average wages throughout their careers, and it would not reduce benefits at all for

⁷¹ For a detailed description of the plan, see Goss, *supra* note 43, at 2.

⁷² Goss, *supra* note 43, at 2 ("Begin by computing the percentage benefit reduction that would apply for the highest career-average earner becoming eligible for a retired worker benefit in each year 2012 and later based on CPI-indexing the PIA formula (as specified in Model 2 of the President's Commission to Strengthen Social Security).").

⁷³ *Id.* at 2 ("Then create a new "bend point" in the Social Security PIA formula at the level of the career-average earnings of the retiree at the 30th percentile of those becoming eligible for benefits in 2010, and wage index this bend point forward like the two current bend points. This new bend point is estimated to be 28.6 percent of the way up from the current first bend point to the current second bend point.").

⁷⁴ *Id.* at 2 ("Calculate the percentage reduction to the "PIA factors" (32 and 15) that applies beyond the new PIA bend point that will provide the benefit reduction described above for the "maximum" earning reaching retirement eligibility for each year 2012 and later.").

⁷⁵ *Id.* at 2 ("This proposal would replicate benefit reductions for the very highest career average earners that are provided under a CPI-indexed benefit formula.").

workers with earnings at or below the 30th percentile of career-average earnings.⁷⁶ Thus, using current figures, workers who earn the taxable maximum — \$94,200 in 2006⁷⁷ — over their lifetime would have their benefits calculated using price indexing, while workers at or below the 30th percentile of career-average earnings — about \$20,000 today⁷⁸ — would have their benefits calculated under the current formula, and those earning between \$20,000 and \$94,200 would receive a benefit somewhere between the benefit provided under current law and that provided under price indexing.

[d] *Costs and Benefits of Progressive Price Indexing*

Without a doubt, the greatest advantage of Pozen's progressive price indexing plan is its potential to reduce Social Security's long-term deficit. According to Social Security Administration projections, this proposal "would reduce Social Security's deficit by 1.4 percent of taxable payroll, or about 74 percent of the [then] estimated 75-year deficit of 1.9 percent⁷⁹ of taxable payroll."⁸⁰ A

⁷⁶ *Id.* at 2 ("Benefit levels would be reduced to a lesser extent for workers with lower career-average earnings, with no reduction for those at or below the 30th percentile of career-average earnings (AIME).").

⁷⁷ See 70 Fed. Reg. 61677 (Oct. 25, 2005) (setting maximum taxable wage for 2006 at \$94,200).

⁷⁸ See Alicia H. Munnell and Mauricio Soto, *What is Progressive Price Indexing?*, Center for Retirement Research at Boston College Just the Facts on Retirement Issues 2 (No. 17 April 2005) (describing "the bottom 30 percent of workers" as those making less than about \$20,000 today).

⁷⁹ In their 2006 report, the Social Security Trustees revised the estimated deficit to 2.02 percent of taxable payroll. Board of Trustees of Fed. Old Age and Survivors Ins. and Disa. Tr. Funds, 2006 Annual Report 2. The increase from 1.92 to 2.02 percent of taxable payroll is attributable to two factors: 1) the fact that the projection period moved forward to include a year with a large deficit, and 2) the fact that the assumed long-term interest rate was reduced from 3.0 to 2.9 percent, which increases the projected present value of projected deficits later in the 75 year valuation period. Alicia H. Munnell, *Social Security's Financial Outlook: The 2006 Update in Perspective*, Boston College Center for Retirement Research Issue Brief No. 46 4 (May 2006).

⁸⁰ Purcell, *supra* note 47, at CRS-8. See also Statement of Pozen, *supra* note 43 ("[Progressive indexing] alone closes 70 percent of the long-term deficit of Social Security, going from \$3.8 trillion to \$1.1 trillion . . ."); Thomas N. Bethell, *Future Shock: Is the latest Social Security proposal for indexing benefits 'progressive' or a body blow to the middle class*, AARP Bulletin Online 2 (June 2005) ("Bush touts his plan as a responsible way to restore Social Security to long-

second advantage of the proposal is that it would protect the benefits of low-wage workers, who rely most heavily on Social Security for their retirement income.⁸¹

The plan, however, would not be costless. First, it would reduce the benefits of average- and high-wage workers. For example, according to calculations by Patrick Purcell of the Congressional Research Service, assuming the Social Security Administration's predictions of price and wage growth of 2.8 percent per year and 3.9 percent per year are accurate, high-wage workers would receive a benefit cut of 17.4 percent and average-wage workers would receive a benefit cut of 13.3 percent by the year 2030.⁸² Using the same assumptions, by the year 2055, high-wage workers would receive a benefit cut of 36.7 percent and average-wage workers would receive a benefit cut of 28 percent,⁸³ and by the year 2080, high-wage workers would receive a benefit cut of 51.5 percent and average-wage workers would receive a benefit cut of 39.3 percent.⁸⁴ Moreover, if real wages were to grow faster, benefit cuts would be even deeper.⁸⁵

Second, by reducing the benefits for high and average-wage workers while retaining the inflation-adjusted growth of benefits for low-wage workers, progressive price indexing would necessarily flatten the Social Security benefit. For example, according to Jason Furman of the Center on Budget and Policy Priorities, in 2045, a high-wage worker, defined as a worker with earnings 60 percent above those of the average worker, would only receive a benefit that was 20 percent higher than that of an average wage worker,

term solvency, claiming it would close about 70 percent of the anticipated shortfall, though some of these savings come from cutting disability and survivors benefits. (Protecting the disabled means the Bush-Pozen plan would close only 50 percent of the gap.)"), available at www.aarp.org/bulletin/socialsec/future_shock.html.

⁸¹ Social Security Administration, *Income of the Aged Chartbook, 2000 22* (released Sept. 2004) (showing that Social Security benefits represent 83 percent of aggregate income for elderly persons in the lowest quintile of income).

⁸² Purcell, *supra* note 47, at Tbl. 1 CRS-11.

⁸³ *Id.* at Tbl. 2 CRS-12.

⁸⁴ *Id.* at Tbl. 2 CRS-12. For additional discussion of estimates, see Jason Furman, *An Analysis of Using "Progressive Price Indexing" to Set Social Security Benefits* 3-4 (May 2, 2005).

⁸⁵ *Id.* at CRS-9.

and by 2075, the high-wage worker's benefit would only be 7 percent higher than that of the average wage worker.⁸⁶

Moreover, if implemented for a long enough period of time, progressive price indexing would, in effect, eliminate Social Security's progressive benefit formula because all workers with earnings above the second bend point (representing the 30th percentile of earnings) would receive the same flat benefit. The leveling of benefits would result from the fact that the PIA factors applied to the two higher earnings brackets would eventually be reduced to zero. According to Purcell's estimates assuming long-run real wage growth of 1.1 percent per year, it would take about 100 years of progressive price indexing for the PIA factors for the two higher brackets to reach zero.⁸⁷ Thus, according to Furman, by 2100, the majority of workers would receive a benefit of \$22,500 per year, which would only replace 9 percent of pre-retirement earnings for a worker who earns the maximum taxable wage throughout his or her career.⁸⁸

By flattening benefits, progressive price indexing threatens to undermine public support for the Social Security system.⁸⁹ As Robert Ball, long-time Commissioner of Social Security has said:

“[Progressive price indexing] really changes the entire philosophy of Social Security. Instead of partially replacing a worker's earnings, it gradually becomes a welfare program paying the same flat benefit to everyone — while protecting only the poorest 30 percent. I can't imagine people continuing to support it, once they realize that the more they contribute, the less they'll get.”⁹⁰

⁸⁶ Furman, *supra* note 82, at 6.

⁸⁷ Purcell, *supra* note 47, at CRS-10.

⁸⁸ Furman, *supra* note 82, at 6.

⁸⁹ See National Committee to Preserve Social Security and Medicare, Social Security: “Progressive” Price Indexing and Middle-Class Benefit Cuts, Viewpoint (May 2005), available at www.ncpss.org/news/archive/vp_priceindex/ (“Over time, all workers would receive essentially the same poverty-level flat benefit, thus converting the current earnings-based program into a welfare payment, and seriously undermining public support for Social Security in the future.”).

⁹⁰ Thomas N. Bethell, *Future Shock: Is the latest Social Security proposal for indexing benefits 'progressive' or a body blow to the middle class?*, AARP Bulletin Online, at 3, available at www.aarp.org/bulletin/socsec/future_shock.html.

[3] Proposal to Fund Personal Retirement Accounts with Social Security's Annual Surpluses

The third proposal to receive considerable attention in 2005 was a proposal to use Social Security's annual surpluses, which are projected to continue through 2016,⁹¹ to fund voluntary personal retirement accounts. On June 23, 2005, Senator Jim DeMint introduced a bill,⁹² entitled the "Stop the Raid on Social Security Act of 2005," that would permit the use of Social Security trust fund surpluses to fund voluntary individual accounts.⁹³ On July 14, 2005, Representative Jim McCrery introduced a similar bill,⁹⁴ entitled the "Growing Real Ownership for Workers Act of 2005," before the House.⁹⁵

In introducing his bill, Senator DeMint declared that "it's time to stop the raid on Social Security. . . Stopping the raid will strengthen Social Security and is the first step toward long-term reform."⁹⁶ Similarly, in introducing his bill, Representative McCrery said, "[S]pending Social Security funds on other programs is wrong and must be stopped. . . . We should ensure that [Social Security's] surplus funds are spent on Social Security."⁹⁷

Like President Bush's proposal, both bills would create voluntary personal retirement accounts.⁹⁸ Unlike the President's proposal, however, the bills would link funding of the accounts to the Social Security Trust Fund's annual surpluses.⁹⁹ Both bills would require

⁹¹ 2006 Annual Report of the Board of Trustees of Federal Old-Age and Survivors Insurance and Disability Trust Funds 2.

⁹² S. 1302, 109th Cong. (2005).

⁹³ 151 Cong. Rec. S27296-01 (June 23, 2005).

⁹⁴ H. R. 3304, 109th Cong. (2005).

⁹⁵ H. R. 3304, 109th Cong. (2005).

⁹⁶ 151 Cong. Rec. S7296-01 (June 23, 2005).

⁹⁷ 151 Cong. Rec. E1499-03 (July 14, 2005).

⁹⁸ See S. 1302, Sec. 251, 109th Cong. (2005). The House bill refers to the accounts as "GROW accounts" rather than personal retirement accounts. H. R. 3304, Sec. 255, 109th Cong. (2005).

⁹⁹ See S. 1302, Sec. 254, 109th Cong. (2005). H. R. 3304, Sec. 254, 109th Cong. (2005).

that plan assets initially be invested in U.S. Treasury bonds, but provide that alternative investments would later be available.¹⁰⁰

Because both bills provide for the creation of voluntary personal retirement accounts, they are generally subject to the same advantages and disadvantages as the President’s proposal.¹⁰¹ They would, however, involve an additional cost. Because the program would only continue so long as the Social Security system runs a surplus, administrative costs for running the program for such a relatively short period time could result in the administrative costs outweighing any benefits. Of course, the proponents hope that once they have opened the door to individual accounts, they would continue beyond 2016 or whenever Social Security ceases to run a surplus.¹⁰²

In addition, by linking the funding of the accounts to the annual surpluses, they open a new issue in the Social Security debate — the trust fund.¹⁰³ While the Republican sponsors of these bills claim that they “would stop the raid” on Social Security’s trust fund surplus, Democrats charge that they would either “‘double count’ assets or force the government to borrow more in the international debt market and thus raise debt and interest costs.”¹⁰⁴ They claim that McCrery’s bill would double count because the accounts would initially be invested in Treasury securities¹⁰⁵ while the trust fund

¹⁰⁰ See S. 1302, Sec. 255, 109th Cong. (2005) (providing for alternative investments beginning in 2008); H. R. 3304, Sec. 256(c), 109th Cong. (2005) (alternative investments would be available “[b]eginning at such time as the Board implements an investment options plan to provide additional and alternative investment options”).

¹⁰¹ See Section 8.02[1], *supra*.

¹⁰² Cf. Elizabeth Grover, *Accounts-Only Bill Best Route, GOP Senate Account Proponents Say*, 32 BNA Pens. & Bene. Rptr. 2055, 2055 (September 27, 2005) (“Democrats in Congress oppose both measures on grounds that they would swell the public debt and represent a back-door effort at ultimately creating far bigger payroll tax-financed accounts along the lines envisioned by the Bush administration.”).

¹⁰³ Jonathan Nicholson, *Shadowy Social Security Surplus Takes Central Role in Retirement Overhaul Debate*, 32 BNA Pens. & Bene. Rptr. 1503 (July 5, 2005) (“With the introduction of two bills that would use the Social Security trust fund surplus to set up personal investment accounts, and resulting criticism from Democrats that such an approach will increase the nation’s debt, the trust fund surplus is fast becoming part of the Social Security debate.”).

¹⁰⁴ *Id.* at 1503.

¹⁰⁵ H. R. 3304, Sec. 256(c), 109th Cong. (2005).

would also be credited with the money.¹⁰⁶ Described by Senator DeMint as “an honest accounting bill,”¹⁰⁷ DeMint’s bill also requires that the accounts initially be invested in Treasury securities,¹⁰⁸ but does not credit the trust fund with the money. The plan does, however, contemplate the government using general revenues to maintain Social Security’s solvency,¹⁰⁹ which Democrats contend will force the government to borrow more money.¹¹⁰ Bob Bixby, executive director of the Concord Coalition, an anti-budget deficit group, has described DeMint’s plan “an incomplete proposal,” more budget reform than Social Security reform.¹¹¹

Senator DeMint and Senator Santorum tried to bring DeMint’s bill to the floor in November but failed to do so.¹¹²

§ 8.03 WHY SOCIAL SECURITY REFORM FAILED IN 2005

Why did Social Security reform, which started with such a flourish at the beginning of 2005, end with a whimper by the close of 2005? Commentators and legislators have offered a variety of explanations.

¹⁰⁶ Nicholson, *supra* note 3, at 1503 (“The accounts would be invested initially in Treasury securities, but the trust fund would also be credited with the money, leading Democrats to charge the plan is ‘double counting.’”). *See also* Jason Furman and Robert Greenstein, *The DeMint and McCrery Social Security Plans 2* (July 19, 2005) (contending that McCrery plan would “double count”), available at www.cbpp.org/6-22-05socsec.htm.

¹⁰⁷ Elizabeth Grover, *Santorum, DeMint Make Last Effort to Revive Social Security Debate in 2005*, BNA Pens. & Bene. Rptr. 2534, 2534 (Nov. 22, 2005).

¹⁰⁸ S. 1302, Sec. 255, 109th Cong. (2005).

¹⁰⁹ S. 1302, Sec. 254(b)(4), 109th Cong. (2005).

¹¹⁰ Nicholson, *supra* note 3, at 1503 (July 5, 2005) (“With the introduction of two bills that would use the Social Security trust fund surplus to set up personal investment accounts, and resulting criticism from Democrats that such an approach will increase the nation’s debt, the trust fund surplus is fast becoming part of the Social Security debate.”).

¹¹¹ *Id.* (“With the introduction of two bills that would use the Social Security trust fund surplus to set up personal investment accounts, and resulting criticism from Democrats that such an approach will increase the nation’s debt, the trust fund surplus is fast becoming part of the Social Security debate.”).

¹¹² Grover, *supra* note 107, at 2534; 151 Cong. Rec. S12828-02 (November 15, 2005).

Some commentators attribute President Bush's failure to reform Social Security to the fact that individual accounts are politically unacceptable.¹¹³ For example, according to a Washington Post editorial:

The Bush team should accept that, as a political matter, it was a mistake to insist that personal accounts be part of reform. These accounts have advantages, especially for less well-off workers who do not already own stocks: They offer a good chance, though not a guarantee, of enhancing retirement by capturing healthy returns from the stock market. But Mr. Bush failed to convince Congress or the nation of this advantage, in part because the economic uncertainty engendered by technology and globalization creates a preference for federally guaranteed benefits. Given the political capital that the newly elected president invested in personal accounts, his failure suggests that they are a non-starter.¹¹⁴

Not all supporters of individual accounts, however, are willing to concede that individual accounts are politically unattainable. Rather, some individual account proponents blame President Bush and his tactics for the failure to achieve Social Security reform in 2005. For example, Republican Senator Clay Shaw notes that President Bush never offered a detailed plan of his own and thus could not unite Republicans behind a single plan. According to Shaw, "You had too many people going off in too many different directions and the whole while the Democrats just trying to sink

¹¹³ Cf. Priya D. Nair, *Bush Acknowledges 'Diminished Appetite' For Addressing Social Security in Short-Term*, 32 BNA Pens. & Bene. Rptr. 2161, 2162 (Oct. 11, 2005) (noting that on October 4, 2005, the National Committee to Preserve Social Security and Medicare (NCPSSM) said that it planned to deliver about 1.5 million petitions expressing opposition to individual accounts. The President of NCPSSM claims the petitions demonstrate "the overwhelming opposition from Americans opposed to Social Security private accounts . . . It's time the private account proponents in Congress listen to what voters are saying . . . no private accounts, not today, not next year, and not ever."); Elizabeth Grover, *Bush Huddles With Commission As Revision Plan's Foes Claim Win*, BNA Pens. & Bene. Rptr. 2054, 2054 (Sept. 27, 2005) (noting that "the union-backed group and top opponent of Bush's Social Security proposal — Americans United to Protect Social Security — said it is close to declaring victory on the issue").

¹¹⁴ Editorial, *A Deal on Social Security*, Washington Post A18 (Oct. 31, 2005).

the whole idea of reform.”¹¹⁵ Republican Senators Gordon Smith and Olympia Snowe blame President Bush for his failure to seek Democratic participation before outlining a plan for individual accounts.¹¹⁶ Republican Senator Rick Santorum suggests that the failure may lie in the fact that President Bush “led with the issue of Social Security” during his 2004 re-election campaign and then took a “two to three month hiatus” from talking about Social Security reform before returning to it during his State of the Union address in February 2005. “Bush’s foes used that hiatus to generate a huge campaign aimed at fighting the White House’s Social Security proposal”¹¹⁷ The Cato Institute contends that the Bush administration used the wrong approach to sell individual accounts; the debate should have focused on ownership and inheritability of individual accounts rather than solvency.¹¹⁸

Kevin Hassett, in an article for Bloomberg.com, suggests that Social Security reform failed because President Bush separated Social Security reform from other legislative initiatives which made reform politically impractical:

From the outset, many in Congress believed Social Security reform could only be achieved if it were included in a broad tax-reform package, or some other, more general legislative action. Only then would the horse traders have enough room to buy the votes needed to push the plan through. By insisting on the separation of Social Security and other initiatives (especially tax reform), the president tied the hands of allies.

It’s easy for the economists on the Council of Economic Advisers to outline Social Security changes; crafting reforms that can become law requires legislative expertise. The men and women

¹¹⁵ Alex Wayne and Martha Angle, *Bush Sees Less Appetite for Social Security Overhaul; Lawmakers Point to the Menu*, Congressional Quarterly Today 12 (Oct. 5, 2005).

¹¹⁶ *Id.* See also Elizabeth Grover, *Sen. Voinovich Proposes Lockbox For Social Security, Other Trust Funds*, 32 BNA Pens. & Bene. Rptr. 2056, 2056 (Sept. 27, 2005) (noting that Republican Senator Voinovich said that Social Security reform “may have been doomed from the beginning because it wasn’t done on a bipartisan basis”).

¹¹⁷ Elizabeth Grover, *Accounts-Only Bill Best Route, GOP Senate Account Proponents Say*, 32 BNA Pens. & Bene. Rptr. 2055, 2055 (Sept. 27, 2005).

¹¹⁸ *New Cato Radio Advertisements Aim To Shift Gears in Debate Over Accounts*, 32 BNA Pens. & Bene. Rptr. 834, 834 (April 12, 2005)

in Congress are the only ones with this expertise. Cutting them out of the process meant that the president went forward with a plan and tactical strategy that turned out to be legislatively impractical.¹¹⁹

In a recent article, *Reforming Retirement Systems: Why the French Have Succeeded When Americans Have Not*,¹²⁰ I examined why the French were able to significantly reform their retirement system in 2003 while the American Social Security system has remained virtually unchanged since 1983.¹²¹ In that article, I offered three principle reasons why the French were able to reform their system in 2003: First, the system was facing serious short-term and long-term funding difficulties, and the public was well-informed about the funding difficulties as well as the possible means of reform.¹²² Second, the government initiated and developed the reform through a very unique and public process of debate, consultation, and negotiation. It intentionally and repeatedly consulted with the trade union organizations and ultimately reached an accord with two trade union federations, the French Democratic Federation of Labor (*Confédération française démocratique du travail* (CFDT)) and the French Confederation of Professional and Managerial Staff-General Confederation of Professional and Managerial Staff (*Confédération française de l'encadrement-Confédération générale des cadres* (CFE-CGC)), prior to introducing the reform before the parliament.¹²³ Finally, Prime Minister Raffarin was absolutely and incontrovertibly committed to reform. He was willing to stake the credibility of his government on the reform and hold firm despite public protests and demonstrations.¹²⁴

Because Congress does not typically negotiate with labor unions before introducing or enacting legislation in the United States, only

¹¹⁹ Kevin Hassett, *How Bush's Social Security Reform Died* (Aug. 1, 2005), available at www.aei.org/publication22926.

¹²⁰ Kathryn L. Moore, *Reforming Retirement Systems: Why the French Have Succeeded When Americans Have Not*, 22 *Ariz. J. of Comp. & Int'l. Law* 251 (2005).

¹²¹ There have been modest amendments to the American Social Security system since 1983, but the last major reform was enacted in 1983. *See* Social Security Amendments of 1983, Pub. L. No. 98-21, 97 Stat. 65 (1983).

¹²² Moore, *supra* note 120, at 270-71.

¹²³ *Id.* at 272-76.

¹²⁴ *Id.* at 277-80.

two of the three reasons pointing to the success of the French reform in 2003 are of relevance in the United States: (1) public education and (2) political commitment. At first blush, it seems that President Bush should have been successful in his effort to reform Social Security. He spent a great deal of time and energy educating the public about Social Security's long-term deficit. In addition, he displayed more political commitment to changing Social Security than we have seen in many years.¹²⁵ Why then did he fail?

First, despite President Bush's attempt to portray Social Security's funding difficulties as an imminent crisis,¹²⁶ the system's funding difficulties are not immediate but long-term in nature.¹²⁷ Historically, the United States has only acted to address Social Security's financing problems when they have been immediate and short-term.¹²⁸

Second, and more importantly, the keystone of President Bush's reform proposal, the creation of individual accounts,¹²⁹ would do absolutely nothing to resolve Social Security's funding problems. Even the White House recognizes that personal security accounts would not solve the deficit.¹³⁰ Indeed, depending on how they are

¹²⁵ See *id.*, at 283–88 (describing lack of political commitment in recent years).

¹²⁶ Cf. Jeff Webb, *On Social Security, residents deserve Brown-Waite's ear*, St. Petersburg Times 2, 2005 WLNR 6667320 (April 28, 2005) ("President Bush is wrapping up a months long campaign to persuade Americans that the [Social Security] system is in crisis and promote his plan to establish private investment accounts for taxpayers."); Ann McFeatters, *No Meeting of Minds Both Sides Fully Mobilized as Debate Begins on Overhauling Social Security*, Pitt. Post-Gazette A1, 2005 WLNR 6560596 (April 27, 2005) ("In a sold-out speech at the National Press Club, Sen. Barack Obama, D-Ill., accused Bush of a 'manufactured panic' in portraying Social Security as in a state of crisis.").

¹²⁷ According to the Social Security Trustees, contributions to Social Security will exceed benefits paid from the system until 2017, and the trust fund will not be exhausted until 2040. Board of Trustees of Fed. Old Age and Survivors Ins. and Disa. Tr. Funds, 2006 Annual Report 2.

¹²⁸ Moore, *supra* note 120, at 286–88.

¹²⁹ See Steven Thomma and Ron Hutchenson, *Bush proposes new benefits system; Wants Social Security to favor the poorest retirees*, Lexington Herald-Leader A1, A12 (April 29, 2005) (noting that at President Bush's prime time news conference, he insisted anew that any Social Security reform plan include private accounts).

¹³⁰ In a private White House memo to conservative allies, Peter Wehner, President Bush's director of strategic initiatives declared, "[w]e simply cannot solve

funded, personal security accounts, could exacerbate Social Security's funding difficulties rather than resolve them because personal security accounts would impose transition of costs of \$1 to \$2 trillion or more.¹³¹ Although President Bush did endorse progressive price indexing,¹³² which would have addressed Social Security's solvency issues, he did not expend the same political capital on promoting progressive price indexing as he did on personal accounts. Instead, he focused most of his efforts on promoting personal accounts which would not solve Social Security's long-term funding deficit.

§ 8.04 FUTURE PROSPECTS FOR SOCIAL SECURITY REFORM

In the short term, the prospect for Social Security reform appears bleak.¹³³ Although President Bush has claimed that Social Security reform is never off the table for him,¹³⁴ Social Security reform clearly appears to have been moved to the back burner.¹³⁵ Despite

the Social Security problem with Personal Retirement Accounts alone. If the goal is permanent solvency and sustainability — as we believe it should be — then Personal Retirement Accounts, for all their virtues, are insufficient to that task." See Jackie Calmes, *White House Memo argues for Social Security Cuts; Note Aims at GOP Backers Of Private Accounts Alone; Threat to Party's Majority?*, Wall St. J. A1 (Jan. 6, 2005).

¹³¹ See *id.* (describing transition costs as equal to \$1 to \$2 trillion); *Social Security Plan Backed*, Deseret News B01, 2005 WLNR 3988642 (March 15, 2005) (stating that transition costs "are expected to be \$1.3 trillion over the next 10 years and \$3 trillion to \$4 trillion in the 10 years after that").

¹³² See *supra* note 44 and accompanying text.

¹³³ Editorial, *A Deal on Social Security*, Washington Post A18 (Oct. 31, 2005) (declaring that "the Bush Administration's declining fortunes have buried the prospect of Social Security reform"); Kevin A. Hassett, *How President Bush's Social Security Reform Died* (Aug. 1, 2005) (announcing "Social Security reform is dead."), available at www.aei.org/publication22926.

¹³⁴ Elizabeth Grover, *Bush Acknowledges "Diminished Appetite" For Addressing Social Security in Short-Term*, BNA Pens. & Bene. Rptr. 2161, 2162 (Oct. 11, 2005) (quoting the President: "Social Security, for me, is never off. It's a long-term problem that's going to need to be addressed. When the appetite to address it is — you know, that's going to be up to the members of Congress.").

¹³⁵ Edwin Chen and Joel Havemann, *Social Security plan withering, Bush Says: Cites More Urgent Needs of Gulf Area*, Lexington Herald-Leader A-8 (Oct. 5, 2005) (noting that "in enumerating his short-term priorities at a nearly hourlong news conference in the White House Rose Garden, the president mentioned only

its prominence in the President's 2005 State of the Union address, Social Security reform played a much more modest role in his 2006 State of the Union address. Rather than promoting any particular reform, the President simply called for the creation of yet another commission¹³⁶ "to examine the full impact of baby boom retirements on Social Security, Medicare and Medicaid."¹³⁷

The prospect for reform appears particularly bleak for 2006 because it is an election year. It seems highly unlikely that Congress would tackle such a controversial issue in an election year.¹³⁸ Indeed, in February 2006, a House Republican leadership aide said, "[I]t would be difficult for us to tackle this [Social Security reform] in a partisan election atmosphere."¹³⁹ Similarly, on November 15, 2005, Senate Finance Committee Chair, Charles Grassley, announced at a meeting before the U.S. Chamber of Commerce that he was "'very pessimistic' about the chances for moving Social Security overhaul through Congress any time soon" and suggested

the war on terror and the hurricane reconstruction" and did not include Social Security reform).

¹³⁶ Over the last decade or so, there have been three different bipartisan commissions to study entitlements, "the Bipartisan Commission on Entitlement and Tax Reform (created in 1994), the National Bipartisan Commission on the Future of Medicare (1997), and the President's Commission to Strengthen Social Security (2001), along with any number of think tank-sponsored reform panels." Editorial, *Dismantling Social Security; Rejected Plan Still Lives*, Philadelphia Inquirer A10 (Feb. 14, 2006).

¹³⁷ Jack Z. Smith, *Presidential Wheel-Spinning on Entitlements*, Augusta Chronicle A05 (March 8, 2006) ("Bush proposed in his Jan. 31 State of the Union speech that Congress join him 'in creating a commission to examine the full impact of baby boom retirements on Social Security, Medicare, and Medicaid.'").

¹³⁸ *Id.* ("It's a safe bet that meaningful solutions to the long-term funding dilemmas facing Social Security, Medicare, and Medicaid will have to be implemented by some future administration and Congress that are more open to true bipartisan cooperation and less ideologically polarized."); Chen and Havemann, *supra* note 1335 at A-8 (Oct. 5, 2005) ("Some lawmakers, such as Sen. Chuck Hagel, R-Neb., have expressed doubt that Congress in an election year would be able to summon the political wherewithal to take on such a hot-button issue. Bush said as much yesterday, noting that such action called for 'political courage.'").

¹³⁹ Amy Fagan, *Critics cry foul in Bush Social Security maneuver Cost of president's plan for personal accounts is in '07 budget*, Washington Times A02 (Feb. 12, 2006).

that reform may not be possible until 2009.¹⁴⁰ He noted that he had held 15 committee meetings on Social Security reform and was still unable to reach consensus among the Republicans on the Senate Finance Committee panel.¹⁴¹

Although the prospect for Social Security reform in the short-term is dim, Social Security reform is inevitable in the long run. The Social Security Trustees project that by 2017, the Social Security system will begin collecting less in contributions than it owes in benefits, and by 2040, the Trust Fund will be exhausted.¹⁴² At that point in time, absent an intervening change in the law, the system will only be able to pay 74 percent of promised annual benefits, and by 2080, the system will only be able to pay 70 percent of promised annual benefits.¹⁴³

While Social Security's long-term financial difficulties are not insignificant, it is important to put the magnitude of the difficulties in perspective. As a percentage of Gross Domestic Product (GDP), Social Security outlays are projected to increase from 4.3 percent of GDP today to 6.2 percent of GDP in 2030, and 6.3 percent of GDP in 2080.¹⁴⁴ Medicare's long-term financing difficulties, in contrast, are "more serious and intractable."¹⁴⁵

According to the Medicare Trustees:

The financial outlook for the Medicare program continues to raise serious concerns . . . Total Medicare expenditures were \$336 billion in 2005 and are expected to increase in future years at a faster pace than either workers' earnings or the economy overall. As a percentage of GDP, expenditures are projected to increase from 2.7 percent in 2005 to 11.0 percent by 2080 (based

¹⁴⁰ Elizabeth Grover and Kurt Ritterpusch, *Grassley Says Social Security Reform Adoption May Not Be Possible Until 2009*, BNA Pens. & Bene. Rptr. 2479, 2479 (Nov. 15, 2005).

¹⁴¹ *Id.*

¹⁴² Board of Trustees of Fed. Old Age and Survivors Ins. and Disa. Tr. Funds, 2006 Annual Report 2.

¹⁴³ *Id.* at 8.

¹⁴⁴ Board of Trustees of Fed. Old Age and Survivors Ins. and Disa. Tr. Funds, 2006 Annual Report 3.

¹⁴⁵ Lawrence Lokken, *A Tax Lawyer's Observations on Scary Numbers, Politics, and Irresponsibility: A Commentary on Shaviro's Reckless Disregard*, 45 B.C. L. Rev. 1335, 1343 (2004).

on our intermediate set of assumptions) . . . [G]rowth of this magnitude, if realized, would . . . substantially increase the strain on the nation's workers, Medicare beneficiaries, and the Federal Budget.¹⁴⁶

Put another way, Social Security's long-term deficit is estimated to be 2.02 percent of taxable payroll.¹⁴⁷ Somewhat simplified,¹⁴⁸ that means that Social Security's 75-year deficit could be solved if the Social Security payroll tax were increased tomorrow by about 2 percentage points – 1 percentage point each for the employee and the employer.¹⁴⁹ For an employee earning the maximum taxable wage of \$94,200 in 2006, such an increase would cost the employee and the employer each about \$940 in 2006. Although it might be possible to solve Social Security's 75-year projected deficit by increasing the payroll tax by 2 percentage points tomorrow, there is no serious proposal before Congress to increase the payroll tax by 2 percentage points tomorrow. Thus, that is unlikely to happen.

Nevertheless, predicting the form Social Security reform will ultimately take is difficult. As a critic of partial privatization of Social Security,¹⁵⁰ I would love to say that the personal account movement is dead and buried. Unfortunately, however, the proponents of individual accounts are a tenacious lot. For example, although President Bush may have given the impression that he had

¹⁴⁶ Boards of Trustees of Fed. Hosp. Ins. and Fed. Supp. Med. Ins. Tr. Funds, 2006 Annual Report 3–4.

¹⁴⁷ Board of Trustees of Fed. Old Age and Survivors Ins. and Disa. Tr. Funds, 2006 Annual Report 2.

¹⁴⁸ Social Security's financing problem is somewhat more complicated than just described. Under current law, the tax rate is fixed while costs are rising. This pattern produces surpluses now and large deficits in the future. As a result of this profile, for each year the projection period moves forward, another year with a large deficit is added to the 75-year deficit. Assuming nothing else changes, this phenomenon will slightly increase the 75-year deficit each year (.07 percent of taxable payroll with today's deficits).

Alicia Munnell, *Social Security's Financial Outlook: The 2006 Update in Perspective*, Boston College Center for Retirement Research Issue Brief 46, at 3 (May 2006).

¹⁴⁹ *Id.* at 3.

¹⁵⁰ See, e.g., Moore, *supra* note 6; Kathryn L. Moore, *Partial Privatization of Social Security: Assessing Its Effect on Women, Minorities, and Lower-Income Workers*, 65 Missouri L. Rev. 341 (2000); Kathryn L. Moore, *Privatization of Social Security: Misguided Reform*, 71 Temple L. Rev. 131 (1998).

conceded defeat in the battle for personal accounts when he did not even mention them in his 2006 State of the Union address, he clearly has not abandoned them. A few days after he gave his 2006 State of the Union address, President Bush submitted his 2007 federal budget. Oblivious to the steadily eroding public support for individual accounts and their inability to close the fiscal gap, President Bush included in his proposed budget costs of \$712 billion over 10 years to fund Social Security Personal Accounts beginning in 2010.¹⁵¹

Similarly, Senator DeMint has not forsaken his proposal to fund individual accounts with the Social Security surplus.¹⁵² On March 16, 2006, DeMint offered an amendment, Amendment No. 3087, to the budget bill.¹⁵³ Although he claimed that his amendment would do “nothing to change Social Security — no privatization, no stock market investment,” Sec. 3 of the amendment expressly “provid[es] the option to voluntarily obtain legally binding ownership of at least some portion of each participant’s benefits.”¹⁵⁴ The proposal was defeated in the Senate by a 53-46 vote.¹⁵⁵

Whether or not partial privatization proponents are ultimately successful, it is clear that Social Security reform must include either benefit cuts or increased taxes or some combination of the two to address Social Security’s long-term deficit.¹⁵⁶ There is simply no magic rabbit, no costless solution to solving Social Security’s long term deficit.

¹⁵¹ Budget of the United States Government, Fiscal Year 2007. Table S-6 p. 321.

¹⁵² 152 Cong. Rec. S2241-01 (March 16, 2006); *see also* Amy Fagan, *Social Security reform rejected; Democrats make it an issue*, Washington Times A04 (March 20, 2006) (discussing proposed amendment).

¹⁵³ 152 Cong. Rec. S2241-01 (March 16, 2006).

¹⁵⁴ 152 Cong. Rec. S2241-01 (March 16, 2006).

¹⁵⁵ 152 Cong. Rec. S2241-01 (March 16, 2006). Democratic Senator Max Baucus is reported to have said, “Any time there’s an opportunity to privatize Social Security, they’ll take it . . . [The DeMint proposal was] evidence today that they’re going to stick with it.” Fagan, *supra* note 139, at A04.

¹⁵⁶ U.S. Gen. Acct. Office, *Social Security: Restoring Long-Term Solvency Will Require Difficult Choices* 9 (1998) (“No matter what shape Social Security reform takes, restoring long-term solvency will require some combination of benefit reductions and revenue increases.”).

Benefit cuts and increased taxes may take a variety of forms.¹⁵⁷ For example, on March 20, 2006, Senator Robert Bennett introduced a bill, “The Sustainable Solvency First for Social Security Act,”¹⁵⁸ that would cut benefits in two ways. First, it would introduce progressive price indexing beginning in 2012.¹⁵⁹ Second, it would accelerate the current law’s scheduled increase in the normal retirement age from 66 to 67 and index the normal retirement age to increases in life expectancy.¹⁶⁰ According to Bennett, the Social Security Administration’s office has certified that his plan would bring solvency to the Social Security system.¹⁶¹

Robert Ball, Commissioner of Social Security under Presidents Kennedy, Johnson, and Nixon, has offered a three part plan to restore solvency to the Social Security system.¹⁶² Unlike Bennett’s proposal, Ball’s proposal would not include any benefit cuts. Instead, it would restore solvency to the system solely by increasing revenue to the system. Ball offers the following justification for limiting changes to those that increase income:

[B]enefits are already being cut in two significant ways — first by changing the retirement age, which alters the benefit formula in a way that has the effect of an across-the-board benefit cut, and second by the ongoing deduction of Medicare premiums from Social Security benefits. So a truly balanced solution to the long-term shortfall must call for more income, not more benefit cuts.

¹⁵⁷ For a discussion of the range of possible options, see Virginia Reno and Joni Lavery, *Options to Balance Social Security Funds over the Next 75 Years*, National Academy of Social Insurance Social Security Brief No. 18 (Feb. 2005), and U.S. Gen. Acct. Off., *Social Security: Different Approaches for Addressing Program Solvency* (1998).

¹⁵⁸ S. 2427, 109th Cong. (2006).

¹⁵⁹ S. 2427, 109th Cong., Sec. 2 (2006).

¹⁶⁰ S. 2427, Sec. 3, 109th Cong. (2006). For an analysis of the costs and benefits of increasing the normal retirement age, see Kathryn L. Moore, *Raising the Social Security Retirement Ages: Weighing the Costs and Benefits*, 33 *Ariz. St. L. J.* 543 (2001).

¹⁶¹ Michael W. Wyand, *Sen. Bennett Introduces Reform Bill, “Under No Illusion” It Will Pass, He Says*, 33 *BNA Pens. & Bene. Rptr.* 714, 714 (March 21, 2006).

¹⁶² Robert M. Ball, *The Social Security Protection Plan: How we can cope — calmly — with the system’s long-term shortfall* (Jan. 2006). For a more detailed discussion of this plan plus three additional elements, see Nancy J. Altman, *The Battle for Social Security: From FDR’s Vision to Bush’s Gamble* 297–309 (2005).

We simply can't afford to reduce the protection that Social Security currently provides. Social Security benefits are the major source of support for two out of every three beneficiaries and are vitally important to nearly all the rest. Benefit levels need to be maintained or even improved, particularly in light of the increasingly uncertain future faced by private pension plans — with traditional defined-benefit plans (many of them underfunded) now covering only about 20 percent of the private-sector workforce, and with the 401(k) individual savings plans that are to some extent replacing the traditional plans subject to the vagaries of individual investment experience and vulnerable to being cashed out before retirement.¹⁶³

The first part of his three part plan consists of gradually increasing the maximum earnings base until it reaches 90 percent of earnings.¹⁶⁴ In the second part of his plan, Ball proposes to dedicate the estate tax to funding Social Security beginning in 2010.¹⁶⁵ The third element of Ball's plan consists of investing a portion of the Social Security surplus in equities.¹⁶⁶

Unlike Bennett and Ball who propose to restore solvency to Social Security solely by reducing benefits or increasing taxes, economists Peter Diamond and Peter Orszag have created a sophisticated three-part proposal that includes a variety of benefit reductions and revenue increases.¹⁶⁷ They believe that “the competing demands of ensuring adequate retirement income for all Americans, restoring long-term balance to Social Security, protecting the program's core social insurance functions, avoiding massive increases in payroll tax rates, and balancing burdens fairly across future workers and retirees require a combination of benefit and tax changes.”¹⁶⁸ Their proposed changes are designed to address the three sources of Social Security's long-term deficit: (1) increasing life expectancy;¹⁶⁹ (2) increased earnings inequality which has

¹⁶³ Ball, *supra* note 162, at 7-8.

¹⁶⁴ *Id.* at 2.

¹⁶⁵ *Id.* at 3.

¹⁶⁶ *Id.* at 4.

¹⁶⁷ Peter Diamond and Peter Orszag, *Saving Social Security* 79 (2004).

¹⁶⁸ *Id.* at 80.

¹⁶⁹ The first element of their proposal, which is designed to address the part

led to a much larger fraction of aggregate earnings not being subject to payroll taxes;¹⁷⁰ and (3) Social Security's legacy debt which arises from the fact that the system paid far more in benefits to the early generations of retirees than they contributed to the system.¹⁷¹

Unfortunately, I am unable to predict which, if any, of these proposals will be successful. I can, however, say with absolute certainty that Social Security reform will require that difficult choices be made, and that costs be imposed on some, if not all, of Social Security participants and beneficiaries.

Difficult though those choices may be, they are not as difficult as the choices faced by Medicare. Social Security's long-term financing difficulties can be solved in any number of ways with sufficient political will. Partial privatization, however, is not one of the ways in which Social Security's financial difficulties can be solved. Partial privatization would only exacerbate the system's current long-term deficit.

of Social Security's imbalance that is attributable to increasing life expectancy, would automatically adjust Social Security benefits and taxes based on contemporaneous projections of life expectancy. *Id.* at 82. Specifically, each year the Social Security Administration would calculate the net cost to Social Security imposed by any increase in life expectancy in the past year for a typical worker at the normal retirement age. *Id.* at 83. Half of the "net cost of increased life expectancy" would be offset by a reduction in benefits while the other half would be reflected in an increase in the tax rate. *Id.* at 83.

¹⁷⁰ The second element of their plan, which is designed to address the increased earnings inequality, consists of gradually increasing the maximum earnings base until it reaches 87 percent of earnings and adjusting the benefit formula to increase the system's progressivity. *Id.* at 85-86. Specifically, they would gradually reduce the third PIA factor (currently equal to 15%) until it reaches 10%. *Id.* at 87.

¹⁷¹ The third and final part of their proposal consists of three changes to address Social Security's legacy costs. *Id.* at 88. First, they propose to extend Social Security coverage to all state and local government employees. *Id.* at 90. Second, they propose a tax on earnings above the maximum taxable wage base that would begin at 3 percent. *Id.* at 92. Finally, they propose a universal legacy charge on payroll taxes and benefits beginning in 2023. "The benefit adjustment would reduce initial benefits for newly eligible beneficiaries by 0.31 percent for each year after 2022[, and t]he revenue adjustment would raise the payroll tax rate by 85 percent of the benefit reduction percentage from this component of the plan." *Id.* at 93.

