# The Face of Social Security in the Twenty-First Century: An Analysis of the Reform Proposals Offered by the Social Security Advisory Council

*Rebecca E. Perrine Wade*

*The Social Security program was created in 1935. This program was developed to provide social insurance to retirees, surviving spouses, and disabled persons. For more than sixty years it has enabled Americans to retire with dignity.*

*However, an unprecedented number of retirees will soon be participating in this program, which will threaten the very existence of the Social Security program. In 1994, the Secretary of Health and Human Services appointed a Social Security Advisory Council to evaluate this situation and propose a solution. The Council recently proposed three different reform plans. The plans range from conservative modifications to radical changes, and all three entail some form of investing in the private sector. Congress has yet to choose the plan that will reform Social Security.*

*In this note, Ms. Rebecca Wade provides a detailed analysis of each reform plan. She discusses the economic and social impact of each proposal and considers how each plan could affect current and future retirees. She reveals that some elements of the proposed plans might sacrifice dignity and security in retirement for the potential economic yield of investments. Ms. Wade urges that policy makers choose the plan that best protects the original public policy concerns behind Social Security.*

## I. Introduction

This note examines the projected long-term insolvency of the existing Social Security system and outlines and analyzes the reform proposals developed by the Social Security Advisory Council. Part II begins with a brief background of Social Security and

Rebecca E. Perrine Wade is a member of the University of Illinois College of Law class of 1998 and of The Elder Law Journal, serving as an Articles Editor in the 1997-98 academic year.

explains the recent demographic shifts that created a long-term financial imbalance in the system. Part II also details the mandate of the Social Security Advisory Council to develop a long-term proposal for reform. Next, this note summarizes the three reform proposals developed by the Social Security Advisory Council.[1] Part III analyzes the effects of each proposal on the economy as a whole. Part IV recommends that reform proposals be evaluated utilizing the original objectives of the Social Security system.

## II. History

### A. Social Security

Social Security trustees[2] report that the Social Security Trust Fund will be exhausted in 2030.[3] Social Security as a whole is composed of two trust funds: the Federal Old-Age and Survivors Insurance (OASI) Trust Fund, which pays retirement and survivors benefits, and the Federal Disability Insurance (DI) Trust Fund, which pays benefits after a worker becomes disabled.[4] The OASI Trust Fund and the DI Trust Fund are separate accounts in the U.S. Treasury.[5] However, when both trust funds are considered together, they are referred to as the Social Security Trust Fund or the OASDI Program.[6] Revenues deposited into these funds include Social Security payroll taxes from workers and employers.[7] These funds pay both Social Security benefits and administrative costs associated with the program.[8]

### B. The Problem with Social Security

The Board of Trustees for the Social Security Trust Fund's Annual Report to Congress details the operations of the trust fund and its projected financial status.[9] As currently structured, Social Security

1. *See infra* text accompanying notes 18-40.
2. *See generally* II REPORT OF THE 1994-1996 ADVISORY COUNCIL ON SOCIAL SECURITY: REPORTS OF THE TECHNICAL PANEL ON TRENDS AND ISSUES IN RETIREMENT SAVINGS, TECHNICAL PANEL ON ASSUMPTIONS, AND METHODS, AND PRESENTATIONS TO THE COUNCIL (1996) [hereinafter REPORT II].
3. *See id.* at 3.
4. *See Actuarial Status of the Social Security and Medicare Programs*, SOC. SEC. BULL., Summer 1995, at 58, 58 [hereinafter *Actuarial Status*].
5. *See id.*
6. *See id.*
7. *See id.* at 59.
8. *See id.* at 58.
9. *See id.*

will fail to achieve its primary goals[10] of ensuring that the elderly are well cared for in retirement and providing the young an opportunity to build sufficient assets to retire with dignity.[11] At the end of fiscal year 1994, the combined Social Security Trust Fund held almost $436 billion in assets, most of which were invested in special interest-bearing federal securities.[12] However, despite the current health of the combined trust funds, the OASI Trust Fund will only be able to pay retirement benefits until 2031.[13]

In both the 1970s and 1980s, Social Security faced similar insolvency problems.[14] In order to place Social Security in a position of long-term financial balance, Congress cut benefits and raised taxes in 1977 and 1983.[15] Obviously, this approach failed to sustain long-term financial stability. Once again, Social Security is faced with insolvency despite previous attempts to decrease benefits and increase contribution rates. Thus, many analysts argue that cutting benefits and increasing taxes will not solve the problem because similar approaches consistently failed in 1977 and 1983.[16] Instead, support is growing for the transition to a privatized structure for Social Security. A privatized structure will, in theory, protect today's elderly, secure higher incomes for future retirees, and provide a lasting solution to Social Security reform.[17]

---

10. *See* William G. Shipman, *Why It's So Hard to Reform Social Security*, PENSIONS & INVESTMENTS, Oct. 31, 1994, at 1, 1.
11. *See id.*
12. *See Actuarial Status*, *supra* note 4, at 59.
13. *See id.* at 61.
14. *See* Shipman, *supra* note 10, at 1.
15. *See id.*
16. *See id.*; William G. Dauster, *Protecting Social Security and Medicare*, 33 HARV. J. ON LEGIS. 462, 476-80 (1996) (describing the amendments to the Social Security Act during this period).
17. *See* Shipman, *supra* note 10, at 1. *See generally Hearing Before the Subcomm. on Soc. Sec. & Family Policy*, 105th Cong. (1996), *available in* 1996 WL 5510507 (statement of Henry J. Aaron, arguing that Social Security structure need not be changed, rather benefits or taxes should be increased or decreased). Despite actuarial predictions, many observers argue that there is no need for reform and that the recent reform debates are no more than a manufactured crisis in order to campaign for privatization. *See generally* Steven J. Devlin Lowell Arye, *The Social Security Debate: A Financial Crisis or a New Retirement Paradigm?*, GENERATIONS, June 1997, at 27; Robert C. Atchley, *Retirement Income Security: Past, Present, and Future*, GENERATIONS, June 1997, at 9. The Social Security Advisory Council is not the only group to develop reform proposals. Reformation is supported by numerous organizations, many of which have generated their own reform proposals: the Center for Economic Development, National Taxpayers Union, the Urban Institute, Progressive Policy Analysis, and Committee to Preserve Social Security and Medicare. *See generally The Future of Social Security for This Generation and the Next: Hearing Before the Subcomm. on Soc. Sec. of the House Comm. on Ways & Means*, 105th

## C. The Social Security Advisory Council

In June 1994, the Secretary of Health and Human Services appointed a thirteen-member Advisory Council on Social Security to review the status of the Social Security Trust Fund.[18] The Council's major task was to develop recommendations for improving the long-range financial status of the Social Security program.[19] After extensive study of the actuarial imbalance, the Council made recommendations for achieving long-range financial stability.[20] The Council members, however, were unable to reach a consensus.[21] Their final report consists of three different plans for improving the long-range financial stability of the Social Security program.[22] Some of the specific provisions involve reductions in spending by changing the Social Security benefits calculation method.[23] Other provisions involve changes in the amount of revenues credited to the trust funds or in the investment policies for the funds.[24]

In developing long-range proposals for Social Security reform, the Advisory Council used the projections and intermediate assump-

---

Cong. (1997), *available in* 1997 WL 11234666 (statements of Representatives Charles W. Stenholm and Jim Kolbe, Co-Chairs, House Public Pension Reform Caucus).

18. *See* I REPORT OF THE 1994-1996 ADVISORY COUNCIL ON SOCIAL SECURITY 2-3 (1996) [hereinafter REPORT I]. The Chair of the Council is Edward M. Gramlich, Ph.D., Dean of the University of Michigan School of Public Policy. *See id.* at 1. Members of the Council include: Robert M. Ball, Founding Chair, National Academy of Social Science; Joan T. Bok, Chairman, New England Electric System; Ann L. Combs, Principal, William M. Mercer, Inc.; Edith U. Fierst, Attorney-at-Law, Fierst & Moss, P.C.; Gloria T. Johnson, Director of the Department of Social Action International Union of Electronic, Electrical, Salaried, Machine, and Furniture Workers, AFL-CIO; Thomas W. Jones, Vice Chairman, President and Chief and Chief Operating Officer, TIAA-CREF; George Kourpias, President, International Association of Machinists and Aerospace Workers, AFL-CIO; Sylvester J. Schieber, Ph.D., Vice President for Government Affairs, AFL-CIO; Marc M. Twinney, Director of Pensions (Retired), Ford Motor Company; Fidel Vargas, Mayor, City of Baldwin Park, California; and Carolyn L. Weaver, Ph.D, Director, Social Security and Pension Studies, The American Enterprise Institute. *See id.*

19. *See* REPORT I, *supra* note 18, at 2-3. Note that the Council's proposals do not address the current financial problems of the Medicare and disability programs. *See id.* at 11-14. *See generally* Dauster, *supra* note 16, at 478-80 (discussing the interrelation of Medicare and Social Security and recommending ideas for reform that serve to jointly protect both funds).

20. *See Actuarial Status*, *supra* note 4, at 1.

21. *See generally* REPORT I, *supra* note 18, at 11-14. For a brief overview of all three plans, see National Academy of Soc. Ins., *Advisory Council on Social Security to Report Soon*, SOC. INS. UPDATE, Dec. 1996, at 1-4.

22. *See generally* REPORT I, *supra* note 18, at 11-14.

23. *See id.* at 20 (discussing extension of the averaging period).

24. *See generally id.* at 25-33.

tions developed by the funds' trustees.[25] The projected Social Security actuarial balance of the trust funds, as developed by trustees, is used as a base line to evaluate the long-term financial status of reform proposals.[26]

The intermediate assumptions indicate that Social Security funds will grow rapidly until 2012, during which time income from taxes will exceed annual expenditures.[27] Currently, the Social Security trust funds consistently realize yearly surpluses.[28] In the year 2013, the trust funds' benefit expenditures will begin to exceed the income that the funds take in through taxation.[29] When the system begins experiencing this negative cash flow, Social Security will begin cashing in Treasury bond holdings.[30] At this time, the principal balance in the funds will diminish quickly and will be exhausted by 2029.[31] The surplus of funds generated today masks the true size of the federal deficit.[32] However, this depletion of funds will unmask the true size of the federal deficit.[33]

A variety of factors contribute to the long-term insolvency problem of the Social Security system. However, there are two main reasons for the predicted insolvency. First, the population is aging due to increased life expectancy.[34] Second, lower reproductive rates are resulting in a smaller work force paying into the Social Security system.[35] Currently, there are 3.2 active workers paying into Social Security for each retired worker.[36] This ratio is expected to decline to

---

25. *See generally* REPORT II, *supra* note 2 (outlining basic assumptions and methods upon which reform proposals are based).
26. *See generally* REPORT I, *supra* note 18, at 11-12 (discussing long-term balance).
27. *See Executive Summaries of the Technical Panel Reports*, SOC. SEC. BULL., Winter 1995, at 98, 98 [hereinafter *Executive Summaries*].
28. For a discussion of the effect of Social Security surpluses on the budget deficit, see Dauster, *supra* note 16, at 478-80; *see also* Richard L. Kaplan, *Top Ten Myths of Social Security*, 3 ELDER L.J. 191, 194-97 (1995).
29. *See Executive Summaries*, *supra* note 27, at 98.
30. *See Status of Social Security and Medicare Trust Funds: Hearings on the Future of Social Security for the Next Generation, Hearings Before the Subcomm. on Soc. Sec. of the House Comm. on Ways & Means*, 105th Cong. (1997), *available in* 1997 WL 10572138, at *8-9 [hereinafter *Status*] (statements of Representatives Charles W. Stenholm and Jim Kolbe, Co-Chairs, House Public Pension Reform Caucus).
31. *See id.* at *3.
32. *See* Dauster, *supra* note 16, at 478-80; *see also* Kaplan, *supra* note 28, at 194-97.
33. *See* Dauster, *supra* note 16, at 478-80; *see also* Kaplan, *supra* note 28, at 194-97.
34. *See* Dauster, *supra* note 16, at 468.
35. *See* Shipman, *supra* note 10, at 2.
36. *See id.* at 3.

2.0 workers for each retiree by the year 2025.[37] In short, the population is aging, and fewer workers are paying payroll taxes to support the growing retired population.[38] This change is not a temporary phenomenon but rather a long-term demographic shift.[39] Given this shift, the Social Security system in its current form is unsustainable.[40]

### D. Reform Proposals

The Council presented three separate proposals in its final report because its members were deeply divided as to the most appropriate means to achieve stability.[41] The final report outlines the general principles upon which the Council agrees and describes three different options for reform. According to actuaries of the Social Security Administration, each of the three plans will restore the actuarial balance of the Social Security Trust Fund by 2070.[42] The three plans are the Maintain Benefits plan, the Individual Account plan, and the Personal Security Account plan.

Initially, the Council considered traditional approaches such as cutting benefits and increasing taxes.[43] They found that an increase in payroll taxes from today's 12.4% to approximately 18% would be required to maintain the current system and sustain benefit levels for all recipients.[44] Similarly, if solvency were restored solely through benefit cuts, benefits would have to be reduced by 25%.[45] Most Council members did not view increased taxes and reduced benefits as viable options given today's political climate.[46]

After determining that the traditional approaches of cutting benefits and increasing taxes were not feasible, the Council began to consider privatization options whereby higher rates of return could be

---

37. *See id.*

38. *See* Ruth Ben-Israel, *Social Security in the Year 2000: Potentialities and Problems*, 16 COMP. LAB. L.J. 139, 150-51, 157-58 (1995).

39. *See id.*

40. *See generally id.* at 150-60.

41. *See* Vineeta Anand, *Social Security Shake-up: Panel to Present 2 Approaches*, PENSIONS & INVESTMENTS, May 29, 1995, at 1.

42. *See* REPORT I, *supra* note 18, at 17.

43. *See* Ann L. Combs, Social Security: Options for Reform 2 (June 10, 1996) (manuscript prepared for the Society of Actuaries' Conference, on file with author).

44. *See id.*

45. *See id.* The 25% decrease would be in addition to the 10% reduction already written into the law in the form of scheduled increases in the normal retirement age. *See id.*

46. *See id.*

realized in comparison to the current pay-as-you-go structure.[47] Thus, a common element of all three proposals is privatization.[48] All of the proposals involve investing some portion of trust fund assets into private markets.[49] However, the methods for investment differ in each of the three plans.[50]

Each of the plans embody several other common elements. Overall, the Council members agree on many general principles for reform. First, the Council agrees that the country should maintain a compulsory retirement program.[51] Second, reform should provide an adequate retirement income relative to poverty thresholds and preretirement income.[52] Third, proposals should provide a degree of income protection, insuring against events which reduce a worker's earning potential including death and disability.[53] Fourth, reform should encourage and promote "equity of lifetime social security taxes and benefits, both between and within generations."[54] Fifth, plans for reform should encourage aggregate national savings.[55] Lastly, the fi-

---

47. *See generally Executive Summaries*, *supra* note 27, at 7-8. Under the current pay-as-you-go system, revenues received from taxation are immediately transferred to retirees as benefits, while revenue surpluses (revenues received in excess of that necessary to pay benefits) are immediately invested into low-yielding government bonds. *See* REPORT I, *supra* note 18, at 17. Thus, there is no real accumulation of reserves into a designated trust.

48. *See* William G. Shipman, *Retiring with Dignity: Social Security vs. Private Markets*, THE CATO PROJECT ON SOC. SECURITY PRIVATIZATION, No. 2 (Aug. 14, 1995) <http://www.cato.org/pubs/ssps/ssp2.html>. *See generally* Karl Borden, *Dismantling the Pyramid: The Why and How of Privatizing Social Security*, THE CATO PROJECT ON SOCIAL SECURITY PRIVATIZATION, No. 1 (Aug. 14, 1995) <http://www.cato.org/pubs/ssps/ssp1.html> (examining Chile's efforts to privatize a national retirement system); Michael Alan Paskin, *Privatization of Old Age Pensions in Latin America: Lessons for Social Security Reform in the United States*, 46 SOC. SECURITY REPORTING SERVICE 761 (1994).

49. *See generally* REPORT I, *supra* note 18, at 25-33.

50. *See id.*

51. *See id.* at 15.

52. *See Executive Summaries*, *supra* note 27, at 98, 100.

53. *See Hearing Before the Subcomm. on Soc. Sec. & Family Planning of the Senate Fin. Comm.*, 104th Cong. (1996), *available in* 1996 WL 5510506, at *2 [hereinafter *Social Security & Family Planning Hearing*] (statement of Olivia S. Mitchell, Executive Director, Pension Research Council Wharton School).

54. *Executive Summaries*, *supra* note 27, at 6; *see also Social Security & Family Planning Hearing*, *supra* note 53, at *2-3 (statement of Olivia S. Mitchell, Executive Director, Pension Research Council Wharton School).

55. *See Executive Summaries*, *supra* note 27, at 98-100; *see also Social Security & Family Planning Hearing*, *supra* note 53, at 3 (statement of Olivia S. Mitchell, Executive Director, Pension Research Council Wharton School). See generally *Proposals for Retirement Policy Reform: Ensuring Our Workers' Retirement Security: Hearings Before the Aging Subcomm. of the Senate Labor & Human Resources Comm.*, 95th Cong. (1996), *available in* 1996 WL 10829686 (statement of Sylvester J. Schieber, Vice Presi-

nancial integrity of retirement institutions, including that of private individual, group, and employer retirement savings plans, should be strengthened by reform.[56] Accordingly, each of the three reform proposals incorporate these principles to a greater or lesser degree depending on the emphasis of the particular proposal. Below is a summary of each plan.

#### 1. MAINTAIN BENEFITS PLAN

Six out of the thirteen members of the Advisory Council support the Maintain Benefits (MB) plan.[57] Under this plan, additional revenue will be raised from increased taxation of benefits and future wages. As a result of a change in federal income taxation of benefits, benefits will be reduced slightly as compared to that under the current system.[58] Basically, this plan maintains the present Social Security benefit and tax structure as is, with either an extension of the benefit computation period or a small increase in the contribution rate and coverage of newly hired state and local government employees.[59]

The MB plan seeks to generate revenues from several sources in order to prolong the date of trust fund exhaustion while keeping the current structure generally intact.[60] Revenue will be redirected to the Social Security Trust Fund from the Hospital Insurance (Medicare)

---

dent, Research and Information Watson Wyatt Worldwide), for a general discussion of the national savings problem as affected by Social Security.

56. *See Social Security & Family Planning Hearing*, *supra* note 53, at *3 (statement of Olivia S. Mitchell, Executive Director, Pension Research Council Wharton School).

57. Members supporting this plan are Robert M. Ball, Gloria T. Johnson, Thomas W. Jones, George Kourpias, and Gerald M. Shea. *See* REPORT I, *supra* note 18, at 25 n.12. *See generally Social Security's Future: Hearing Before the Subcomm. on Soc. Sec. & Family Policy of the Senate Fin. Comm.*, 104th Cong. (1996), *available in* 1996 WL 7137338 [hereinafter *Future*] (statement of Edith U. Fierst, Member, 1994-95 Advisory Council on Social Security). Edith Fierst favors most, but not all, provisions of the plan. *See* REPORT I, *supra* note 18, at 25 n.12

58. *See* REPORT I, *supra* note 18, at 25.

59. *See id.*

60. **Projected Reduction in Payroll Debt**

| | | |
|---|---|---|
| | | 2.17 percent |
| increased taxes | –.31 | |
| redirection of funds | –.31 | |
| new hires | –.22 | |
| adjustment CPI | –.31 | |
| computation period 35 to 38 | –.28 | |
| adjustment safeguard | +.06 | |
| | –1.37 | |
| | | .80 percent deficit remaining |

*See id.* at 80.

Trust Fund. Currently, a portion of revenue from taxation of OASDI benefits is credited to the Medicare Trust Fund.[61] Under the MB plan, this revenue will be redirected to the OASDI Social Security Trust Funds.[62]

To ensure that this plan will not drift out of balance because of the passage of time, revenues will be increased through higher payroll tax rates for workers beginning in about 2045.[63] Adoption of this plan within the next year or two will reduce the 2.17% deficit in Social Security funding to .80%, postponing the estimated trust fund exhaustion date from 2030 to 2050.[64]

After a period of study and evaluation, the plan envisions investment of accumulated assets through a passive equity index fund[65] held and managed by the federal government.[66] The sole purpose of investment in equities is to secure a rate of return higher than that realized under the current practice of investing funds in government bonds.[67] As a result, the remaining deficit is projected to be eliminated through investment in private stocks.[68]

Accordingly, the Council as a whole favors a move from the current pay-as-you-go system to a partial advance funding of Social Security.[69] In order to achieve partial advance funding, the MB plan proposes a change in investment policy.[70] Under this plan, 40% of assets will be invested in private equities, rather than Treasury securities.[71] Historically, the differential between the real returns[72] on gov-

---

61. *See id.* at 25.
62. *See id.*
63. *See id.* Other than the possible increase in 1998, deductions from workers' earnings and employer matching contributions would not increase for 50 years, at which time the combined employer-employee payroll tax rate would be increased by 1.6 percentage points. *See id.*
64. *See id.*
65. Equities are shares of corporate capital which are more commonly known as "stocks." *See id.* at 259.
66. *See id.* at 25.
67. *See id.* at 27; *see also* Kaplan, *supra* note 28, at 205-06 (discussing current investment policy).
68. *See* REPORT I, *supra* note 18, at 25.
69. *See id.*
70. *See id.*
71. *See Toward Personal Savings Accounts Under Social Security: Some Issues and Options: Hearing Before the Subcomm. of Soc. Sec. & Family Policy of the Senate Fin. Comm.*, 104th Cong. (1996), *available in* 1996 WL 267429, at *7 [hereinafter *Personal Savings*] (statement of Carolyn L. Weaver, Director, Social Security and Pension Studies, American Enterprise Institute).
72. Real rates of return reflect the effects of inflation. *See* REPORT I, *supra* note 18, at 260.

ernment bonds and real returns on stocks has been about 4.7% per year.[73] As such, the long-term differential return on investment can make a major difference in moving the fund toward partial advanced funding.[74] The government will begin investing portions of the trust fund assets in private equities in the year 2000 with the invested portion rising to about 40% by 2014.[75] The assets will reach the dollar equivalent of more than $1 trillion (in constant 1995 dollars) by 2020.[76]

Proponents of the MB plan support a conservative investment strategy similar to that of private pension standards.[77] A conservative investment approach is consistent with the policies and goals underlying the inception of the Social Security program.[78] In evaluating the proposal, actuaries estimate that the overall increase in risk of investment in private equities is only slightly increased as compared to the current risk associated with investment in government bonds.[79]

Investment policy will be administered by an investment policy board to be appointed by the President and confirmed by the Senate.[80] The policy board will be held to a legislative fiduciary standard. The board's sole objective is investment for the economic benefit of Social Security participants, and not the advancement of any social or political objectives.[81]

#### 2. INDIVIDUAL ACCOUNT PLAN

Other members of the Council support the Individual Account (IA) plan.[82] Under this proposal, taxes are paid into mandatory individual accounts for workers.[83] The government will hold the

---

73. *See id.* at 26.
74. *See id.* at 25.
75. *See id.* at 26.
76. *See Personal Savings*, *supra* note 71, at *7 (statement of Carolyn L. Weaver, Director, Social Security and Pension Studies, American Enterprise Institute). This option assumes that the overall rate of return on trust fund assets will increase from the current 2.3% real to 3.8% real. *See id.*
77. *See* REPORT I, *supra* note 18, at 26.
78. *See id.*
79. *See id.*
80. *See id.*
81. *See id.*
82. Members endorsing the IA plan are Edward M. Gramlich and Marc M. Twinney. *See id.* at 28 n.14. *See generally Status*, *supra* note 30 (statement of the Honorable Beau Boulter, Legislative Counsel, United Seniors Association, Inc., urging maintenance of the Social Security safety net through implementation of the two-tier system).
83. *See* REPORT I, *supra* note 18, at 28. *See generally Personal Savings*, *supra* note 71 (statement of Carolyn Weaver, Director, Social Security and Pension Studies,

mandatory individual accounts within the Social Security Trust Fund.[84] This approach reduces the growth rate of basic benefits[85] by extending the computation period from thirty-five to thirty-eight years and by increasing the normal retirement age.[86] The normal retirement eligibility age will be gradually increased to age sixty-seven.[87] Thereafter, beginning in 2012, when the eligibility age is sixty-seven, the normal retirement age will continue to be indexed upward to keep up with increases in longevity at a rate of one month every two years.[88] These changes are gradually phased in to allow benefits to be financed with the current 12.4% payroll tax.[89] This combination of reduced growth of benefits, increased age of eligibility, and accumulated assets in individual accounts will result in total average benefit levels comparable to that of present levels for all income groups.[90]

An additional mandatory earnings tax of 1.6% will also be paid into the mandatory individual retirement accounts.[91] The accumulated individual account funds will be invested in a wide range of portfolios.[92] The government will offer limited choices for individual account fund investment.[93] However, as under the current system,

---

American Enterprise Institute, discussing general implications of mandatory individual accounts).

84. *See* REPORT I, *supra* note 18, at 28.

85. *See id.*

86. *See id.*

87. *See id. See generally Personal Savings, supra* note 71 (statement of Carolyn Weaver, Director, Social Security and Pension Studies, American Enterprise Institute, discussing general implications of mandatory individual accounts).

88. *See* REPORT I, *supra* note 18, at 28-29.

89. *See id.* at 29.

90. *See Future of Social Security: Hearing Before the Subcomm. on Soc. Sec. of the House Comm. on Ways & Means*, 105th Cong. (1997), *available in* 1997 WL 141249, at *2 (statement of Edward M. Gramlich, Dean, School of Public Policy, The University of Michigan Chair, 1996 Quadrennial Advisory Council on Social Security).

91. *See* REPORT I, *supra* note 18, at 28; *see also Status, supra* note 30, at *2 (statement of Edward M. Gramlich, Dean, School of Public Policy, The University of Michigan Chair, 1996 Quadrennial Advisory Council on Social Security). *See generally Personal Savings, supra* note 71 (statement of Carolyn Weaver, Director, Social Security and Pension Studies, American Enterprise Institute, discussing the implications of an additional mandatory 1.6% tax on payroll).

92. *See* REPORT I, *supra* note 18, at 28; *see also Future of Social Security: Hearing Before the Subcomm. on Soc. Sec. of the House Comm. on Ways & Means*, 105th Cong. (1997), *available in* 1997 WL 141249, at *2 (statement of Edward M. Gramlich, Dean, School of Public Policy, The University of Michigan Chair, 1996 Quadrennial Advisory Council on Social Security, discussing investment options).

93. *See* REPORT I, *supra* note 18, at 28.

the assets of the central trust will continue to be invested in Treasury bonds.[94]

The earliest eligibility for benefits under the IA plan will remain age sixty-two.[95] Upon retirement, individuals will convert accounts to single or joint minimum guarantee indexed annuities.[96] A minimum guarantee annuity ensures that at least some portion of the purchase price of the annuity will be paid to beneficiaries in all cases.[97] For example, if a retiree died after receiving only one payment, an additional minimum amount would be paid to survivors.[98]

Taxation of individual accounts will occur in either of two ways: (1) contributions may be tax deductible when saved but taxable when benefits are paid; or conversely, (2) contributions may be taxable when saved but deductible when received.[99] In either case, the effect of taxation on overall benefits is the same.[100]

The IA plan contains many provisions identical to that of the MB plan. The plan proposes to cover all new state and local government employees hired after 1997.[101] The plan also includes a provision that increases survivor benefits for double-income couples, while at the

---

94. *See id.*
95. *See id.*
96. *See id.; see also Future of Social Security: Hearing Before the Subcomm. on Soc. Sec. of the House Comm. on Ways & Means*, 105th Cong. (1997), *available in* 1997 WL 11234134, at *20 (statement of Kelly Olsen, Research Analyst, Employee Benefit Research Institute, and Paul J. Yakoboski, Senior Research Associate, Employee Benefit Research Institute, noting that currently few retirees annuitize IRA benefits suggesting that annuitization is not an effective management tool of retirement income).
97. *See* REPORT I, *supra* note 18, at 28; *see also Future of Social Security: Hearing Before the Subcomm. on Soc. Sec. of the House Comm. on Ways & Means*, 105th Cong. (1997), *available in* 1997 WL 11234134, at *20 (statement of Kelly Olsen, Research Analyst, Employee Benefit Research Institute, and Paul J. Yakoboski, Senior Research Associate, Employee Benefit Research Institute, noting that currently few retirees annuitize IRA benefits suggesting that annuitization is not an effective management tool of retirement income).
98. *See* REPORT I, *supra* note 18, at 28; *see also Future of Social Security: Hearing Before the Subcomm. on Soc. Sec. of the House Comm. on Ways & Means*, 105th Cong. (1997), *available in* 1997 WL 11234134, at *20 (statement of Kelly Olsen, Research Analyst, Employee Benefit Research Institute, and Paul J. Yakoboski, Senior Research Associate, Employee Benefit Research Institute, noting that currently few retirees annuitize IRA benefits suggesting that annuitization is not an effective management tool of retirement income).
99. *See* REPORT I, *supra* note 18, at 29.
100. *See id.*
101. *See id.; see also Future of Social Security: Hearing Before the Subcomm. on Soc. Sec. of the House Comm. on Ways & Means*, 105th Cong. (1997), *available in* 1997 WL 141249, at *1 (statement of Edward M. Gramlich, Dean, School of Public Policy, The University of Michigan Chair, 1996 Quadrennial Advisory Council on Social Security).

same time reducing dependent spousal benefits.[102] Likewise, the period for benefit calculation will be extended from thirty-five to thirty-eight years.[103] As in the Maintain Benefits plan, income thresholds for taxation are phased out, and Social Security taxes are based on basic income tax principles.[104]

3. **PERSONAL SECURITY ACCOUNT PLAN**

A third group of Council members favor the Personal Security Account (PSA) plan.[105] The PSA plan creates a two-tier system of individual accounts whereby a substantial portion of the program will be fully funded.[106] The first tier consists of a flat-dollar retirement benefit covering all workers.[107] The second tier consists of fully funded individually owned retirement accounts known as personal security accounts.[108] A payroll tax of 1.5% of earnings and funds borrowed from the Treasury will be used to cover the costs of transitioning to the new system.[109] Generally, survivor and disability benefits are slightly modified; however, combined benefits will generally exceed those under the current system for most workers across all income levels.[110]

First, 5% of the payroll tax is redirected to personal security accounts to be invested in the financial markets and held for retirement

102. *See* REPORT I, *supra* note 18, at 29.
103. *See id.*
104. *See id.*
105. Members supporting the PSA plan are Joan T. Bok, Ann L. Combs, Carolyn L. Weaver, Sylvester J. Schieber, and Fidel A. Vargas. *See* REPORT I, *supra* note 18, at 30 n.20.
106. *See id.* at 30.
107. *See id. See generally Personal Savings*, *supra* note 71 (statement of Carolyn Weaver, Director, Social Security and Pension Studies, American Enterprise Institute, discussing the tax implications of personal savings accounts).
108. *See* REPORT I, *supra* note 18, at 30.
109. *See id.*; *see also Personal Savings*, *supra* note 71, at *9 (statement of Carolyn Weaver, Director, Social Security and Pension Studies, American Enterprise Institute). *See generally Reforming Social Security to Accommodate the Challenges and Opportunities Ahead: The Role of Personal Accounts: Hearing Before the Subcomm. on Aging of the Senate Comm. on Labor & Human Resources*, 104th Cong. (1996), *available in* 1996 WL 264390, at *8 [hereinafter *Reforming*] (statement of Carolyn Weaver, Director, Social Security and Pension Studies, American Enterprise Institute, discussing the costs of transition); *Personal Security Accounts: A Proposal to Strengthen Social Security and Improve the Value of the System for Younger Workers: Hearing Before the Senate Budget Comm.*, 104th Cong. (1997), *available in* 1997 WL 32752, at *10-13 [hereinafter *Proposal*] (statement of Carolyn Weaver, Director, Social Security and Pension Studies, American Enterprise Institute, discussing the implications of massive borrowing).
110. *See* REPORT I, *supra* note 18, at 30-31.

purposes.[111] Next, the current benefit formula calculus is replaced by a smaller, flat benefit of approximately $410 per month for future retirees under the age of twenty-five in 1998.[112] This flat benefit will be funded with 7.4% of the current 12.4% payroll tax and invested in Treasury bonds.[113] Workers under the age of fifty-five, however, will continue to be covered by the existing system and will continue to pay full payroll taxes.[114]

Non-full-career workers, those working less than thirty-five years, will be eligible to receive half of the flat benefit by working ten years, with a 2% increment increase in benefits for each additional year of work up to twenty-five years.[115] Non-full-career workers are also subject to generally applicable changes in the retirement ages and the taxation of benefits.[116] Individuals who are between the age of twenty-five and fifty-four in 1998 will receive a combination of their accrued benefits under the existing system, as well as a prorated share of the first-tier flat benefit.[117]

Both first-tier and second-tier benefits will be taxed under basic income tax principles, in effect phasing out income taxation thresholds used under current law.[118] Contributions to PSAs will be after-tax but benefits will be tax-free when received.[119]

Implementation of this plan would begin in 1998 whereby workers age twenty-five and under, as well as future generations, are totally covered under the new system.[120] Workers under twenty-five will receive benefits only under the new system with the government

111. *See id.*

112. *See id.* The flat benefit is approximately 65% of the poverty level for an individual living alone and 76% of the benefit level payable to a full-career worker with low average earnings retiring under the system. *See generally Proposal*, *supra* note 109, at *8 (statement of Carolyn Weaver, Director, Social Security and Pension Studies, American Enterprise Institute, discussing flat benefit levels for various income groups).

113. *See* REPORT I, *supra* note 18, at 30; *see also Personal Savings*, *supra* note 71, at *6, 14 (statement of Carolyn Weaver, Director, Social Security and Pension Studies, American Enterprise Institute).

114. *See* REPORT I, *supra* note 18, at 30.

115. *See id.* at 31.

116. *See id.* at 30.

117. *See id.* at 31.

118. *See also Personal Savings*, *supra* note 71, at *9 (statement of Carolyn Weaver, Director, Social Security and Pension Studies, American Enterprise Institute).

119. *See* REPORT I, *supra* note 18, at 69.

120. *See id.* at 30.

providing first-tier payments and second-tier payments based on accumulations in individual accounts.[121]

The PSA plan also has several provisions in common with the two former plans. All new state and local government employees hired after 1997 are brought into the system.[122] Likewise, survivors' benefits will increase and spousal benefits will change.[123] The earliest eligibility age for the full-retirement flat benefit is increased from age sixty-five to sixty-seven.[124] However, as compared to the IA proposal, the PSA plan will permit withdrawal of PSA balances beginning at age sixty-two, and any balance remaining in a PSA at the death of the owner is includable in the decedent's estate.[125]

## III. Analysis

### A. Maintain Benefits Plan

Except for the change in investment policy, Social Security remains fundamentally unchanged under the MB plan.[126] MB plan proponents urge that the nation's basic retirement system should not require individuals to bear investment risks as with the IA and PSA plans.[127] The MB plan provides for a central fund broadly indexed to the stock market providing investment stability with minimal risk.[128] Furthermore, benefits will not be dependent on assumed private rates of return.[129] The assumed rate of return remains important but secon-

---

121. *See id.*

122. *See id.*

123. *See id.*

124. *See id.* at 31; *see also Reforming, supra* note 109, at *11 (statement of Carolyn Weaver, Director, Social Security and Pension Studies, American Enterprise Institute).

125. *See Personal Savings, supra* note 71, at *7 (statement of Carolyn Weaver, Director, Social Security and Pension Studies, American Enterprise Institute); REPORT I, *supra* note 18, at 30. *See generally* Lewis D. Solomon, et al., *Privatization of Social Security: A Legal and Policy Analysis*, 5 KAN. J.L. & PUB. POL'Y 9 (1995) (discussing privatization). Early retirement eligibility age will increase as the eligibility age for full retirement increases, reaching 65 by 2035. *See generally* REPORT I, *supra* note 18, at 31.

126. *See* REPORT I, *supra* note 18, at 86.

127. *See id.* Many observers insist that the Social Security system should remain primarily that of a social insurance program rather than an investment vehicle. *See generally* Mary Kuntz, *It Wasn't Meant to Be Fair: The Social Security Bite*, FORBES, Apr. 7, 1986, at 118.

128. *See* REPORT I, *supra* note 18, at 86; see also Jacki Calmes, *Clinton Panel Cites 'Risk' in Putting Social Security Funds in Stock Market*, WALL ST. J., Feb. 11, 1997, at A2, for a discussion of the necessity to maintain the social insurance role of Social Security, stressing the consequences when markets fall.

129. *See* REPORT I, *supra* note 18, at 86.

dary because benefits remain defined by law rather than by the relative uncertainty of individual investment decisions.[130]

Likewise, this plan takes a conservative approach to the redirection of Medicare funds. As previously discussed, revenues from the taxation of Social Security benefits will be gradually redirected from the Medicare fund to the Social Security OASDI fund when Medicare is refinanced.[131] This redirection of funds will reduce the Social Security deficit by .31%.[132] In comparison, the PSA plan proposes an immediate withdrawal of funds from the Medicare fund, which will accelerate that trust fund's exhaustion date.[133]

In terms of maintaining adequate retirement income, MB plan proponents maintain that cost-of-living-adjustments (COLAs) are the most important feature of Social Security.[134] Under the current system, COLAs are based on the consumer price index (CPI) developed by the Bureau of Labor Statistics (BLS).[135] Based on these statistics, Social Security benefits are adjusted upward to keep up with inflation.[136] However, MB proponents urge that the CPI overestimates current rates of inflation and as a result Social Security benefits are overadjusted upward.[137] Proponents of the MB plan contend that to protect the integrity of the Social Security COLA computation, the BLS should modify the CPI to more accurately reflect inflation rates.[138] Accordingly, benefits will be adjusted upward by a lesser rate, more accurately reflecting the actual rate of inflation.[139]

To ensure equity in taxation and lifetime benefits between and within generations, proponents of the MB plan believe in preserving

---

130. *See id.*
131. *See id.* at 78. When baby boomers begin to retire, the Medicare program must be refinanced. *See id.* This change will have to occur sometime between 2010 and 2020. *See id.*
132. *See id.*
133. *See id.*
134. *See id.* at 79.
135. *See id.* at 78. See generally *The Final Report of the Advisory Comm. to Study the Consumer Price Index Before the Senate Comm. on Fin.*, 104th Cong. (1997), *available in* 1997 WL 8218852 [hereinafter *CPI Report*] (statement by Tess Canja, American Association of Retired Persons) for an in depth analysis of the CPI calculation and application in the context of governmental programs.
136. *See* REPORT I, *supra* note 18, at 78.
137. *See id.*
138. *See id.*
139. Change in the CPI calculation would decrease the long-term deficit by .31% of payroll. *See id.* at 78-79. *See CPI Report*, *supra* note 135, at *3-4 (Tess Canja, American Association of Retired Persons, discussing the AARP opposition to CPI adjustment).

intergenerational equity by making current retirees contribute, along with current wage earners, to ensure the long-term stability of the Social Security system. MB proponents argue that intergenerational equity is justified because Social Security benefits all taxpayers in that it prevents the elderly from being a tax burden on welfare and other social relief programs.[140] The MB plan presents two possible options to ensure that the burden is shared equally by retirees and current wage earners.

Option one of the MB plan seeks to reduce benefits, thus raising revenues, by changing the averaging period used to calculate Social Security benefits.[141] Under this proposal the period will be increased from thirty-five to thirty-eight years, decreasing average benefits by 3% for future beneficiaries.[142] Consequently, there will be a more substantial benefit decrease for intermittent wage earners as opposed to "those with histories of consistent employment over the full thirty-eight years."[143] From a practical standpoint, this provision will affect women because women are more likely to leave the work force and then reenter.[144] However, the entire system will remain substantially redistributive favoring those moving in and out of the work force.[145]

Option two of the MB plan will raise contribution rates by .15%.[146] This plan will have the same effect as option one in terms of the fund's status at the end of the seventy-five-year period.[147] Increased taxation ensures that future beneficiaries contribute to solving the long-term deficit but not to the point of creating significant hard-

---

140. *See* REPORT I, *supra* note 18, at 78.

141. *See id.* at 79.

142. *See id.*

143. *Id.*

144. *See id.* at 79 n.*.

145. *See id.* This reduction will result in a .28% decrease in the long-term deficit. *See id.* at 79.

146. *See id. See generally The Future of Social Security for This Generation and the Next: Hearing Before the Subcomm. on Soc. Sec. of the House Comm. on Ways & Means*, 105th Cong. (1997), *available in* 1997 WL 11234670 (statements of U.S. Representative Earl Pomeroy, Democrat, North Dakota, speaking out against any additional increases in contribution rates); *The Future of Social Security for This Generation and the Next, Hearing Before the Subcomm. on Soc. Sec. of the House Comm. on Ways & Means*, 105th Cong. (1997), *available in* 1997 WL 11234666 (statements of Representatives Charles W. Stenholm and Jim Kolbe, Co-Chairs, House Public Pension Reform Caucus, noting that although contribution rates increased 20 times since the inception of the Social Security system in 1937, this approach failed to lead to long-term stability).

147. *See* REPORT I, *supra* note 18, at 79.

ship.[148] This tax is roughly equivalent to $15 per year for $10,000 of wages, or $1.41 per month for a minimum wage earner.[149]

This plan also proposes a progressive income tax on benefits received in excess of the amount which was paid in; as such, the taxation burden will be fairly distributed among those most able to help.[150] Next under the MB plan, there will be a repeal of the special exemption from income tax for certain Social Security beneficiaries. Those currently exempt include individuals making less than $25,000 per year and couples earning less than $32,000.[151] The special exemption repeal and concurrent taxation will reduce the long-term deficit by .31% of payroll.[152]

Consistent with the MB plan's conservative approach, proponents built in an additional provision to safeguard against the plan drifting out of balance over time.[153] Even though, as a theoretical assumption, the deficit will be eliminated in seventy-five years, the plan is still vulnerable to drifting out of balance due to the passage of time.[154] The plan provides for a .80% employee contribution tax concurrent with an employer matching tax which will be effective in fifty years.[155] Although this tax may prove to be unnecessary, it is built into the law to maintain a stable ratio of current trust funds to the next year's outgoing funds.[156]

Despite these safeguards, a funding deficit of .80% of payroll remains under the MB plan.[157] This leaves the system financially vulnerable, merely postponing the date of trust fund exhaustion rather than solving the actuarial imbalance.[158] However, proponents of this proposal point out that the plan leaves the system very "close to actu-

148. *See id.*
149. *See id.*
150. *See id.* at 78.
151. *See id.*
152. *See id.*
153. *See id.* at 86.
154. *See id.*
155. *See id.* at 87.
156. *See id.*
157. *See id.* at 80.
158. *See id.* In comparison, the trustees of private pension systems and managers of state pension systems have the authority to invest more broadly and would be castigated if they adopted the ultraconservative investment policy under today's structure. *See id.* at 83.

arial balance."[159] As the term is defined, the Social Security system is deemed to be in "actuarial balance" with a .75% payroll deviation.[160]

Further, proponents contend that the increased revenues from investment in private equities would eliminate the remaining .80% long-term deficit.[161] After further study and evaluation of privatization, proponents of this plan suggest the possibility of investing in private markets. The MB plan proposes to invest less than 40% of accumulated funds in private equities by about 2015, eliminating the remaining deficit.[162]

Under this plan, a neutral investment policy will be established by law.[163] The ultimate objective will be investment "solely for the economic benefit of Social Security participants and not for any other economic, social or political objective."[164] Ideally, Congress will engage in a passive investment strategy, seeking favorable rates of return while exposing workers and retirees to minimal risk.[165]

By the year 2015, assets will be approximately $1 trillion in 1996 dollars.[166] However, the pressure to use these funds to achieve socially and politically desirable goals may be great.[167] Moreover, even if the current Congress does refrain from using these funds for political goals, there is no assurance that future Congresses will be able to do the same.[168] For instance, Congress used federal pension funds to avoid debt ceiling limits during the budget crisis of early 1996.[169] Further, imagine the pressure on Congress to drop from the investment portfolio tobacco companies or companies with unfavorable labor practices, while at the same time, facing pressure to add companies

159. *See id.* at 80.
160. *See id.*
161. *See id.* at 83.
162. *See id.* at 84.
163. *See id.*
164. *Id.* First, a passive market would be selected. *See id.* Next, several leading passive equity index portfolio managers with experience in the management of large accounts would be selected through bidding. *See id.* Lastly, mechanisms would be established to review the operation of the plan with reports to Congress and the public. *See id.* This plan will parallel that of the Federal Retirement Thrift Investment Board Administration for the Thrift Savings Plan for Federal Employees. *See id.*
165. *See id.* at 126.
166. *See id.*
167. *See id.* at 127.
168. *See id.*
169. *See id. See generally* Krzysztof M. Ostaszewski, *Privatizing the Social Security Trust Fund? Don't Let the Government Invest,* THE CATO PROJECT ON SOCIAL SECURITY PRIVATIZATION, No. 6 (Jan. 14, 1997) <http://www.cato.org/pubs/ssps/ssp6.html>.

with favorable labor practices[170] or those pursuing socially desirable goals. More importantly, the government's role will change from that of a regulator to a fiduciary of Social Security participants.[171]

Accordingly, there is, of course, always the risk that politicians will change the index of government investment to preferred social objectives.[172] However, once the objective of neutrality is established, the checks and balances of the competing political arena will ensure the protection of that objective.[173] For instance, an attempt to alter the neutral objective of Social Security investment will be a major point of political attack.[174] Politicians will be reluctant to interfere in an area where all American families have a stake.[175] Furthermore, the same forces that have kept the current Social Security system substantially intact will work to ensure the success of the new system.[176]

Investment in private equities, however, raises concerns about the overall effect of such massive investment on the market.[177] Although Social Security is a large portion of the government's total operations, it is a relatively small part of the nation's $7.5 trillion economy.[178] Social Security's annual stock transactions would involve less than 1% of the value of all U.S. equities. In the year 2014, at the peak of investment, Social Security stock transactions will involve less than 5% of the value of all stocks.[179]

In sum, the central criticisms of the MB plan include the fact that the plan ultimately leaves one-third of the long-term deficit unresolved and the general opposition to central government invest-

170. *See* REPORT I, *supra* note 18, at 127.
171. *See id.*
172. *See id.* at 85.
173. *See id.* Although Social Security will be the largest defined-benefits retirement system to invest a significant portion of assets in the stock market, it will not be the first. *See id.* The Tennessee Valley Authority has invested approximately 40% of its $3.8 billion holdings in the stock market. *See id.* The Federal Reserve System places approximately two-thirds of its $2.9 billion in assets in stocks. *See id.* Similarly, systems covering Army and Air Force exchanges have invested 80% of their $1.9 billion in assets in stocks. *See id.* Since inception, none of these plans have been politically influenced in investment selection. *See id.*
174. *See id.*
175. *See id.*
176. *See id.*
177. See Ostaszewski, *supra* note 169, for the proposal that government management is tantamount to the socialization of the U.S. economy.
178. *See* REPORT I, *supra* note 18, at 84.
179. *See id.* More importantly, Social Security holdings must have a neutral effect on stockholder voting and company policies. *See id.* at 84-85. This neutrality could be accomplished by prohibiting voting on any stocks held by Social Security. *See id.* at 85.

ment.[180] Another major flaw in this plan is that "neither redirecting funds nor investing part of the trust funds in equities will assist the economy in preparing for the coming boost in ratio of retirees to workers."[181]

The strengths of the MB plan are many, as it builds on, but does not replace, the existing Social Security system.[182] The plan entails minor changes to the current system consistent with traditional policy.[183] This plan improves protection against inflation and provides better protection for surviving spouses and the disabled as compared to the IA and PSA plans.[184] The essential principles of Social Security remain undisturbed; long-term balance is restored; and the plan provides the same stock investment benefits enjoyed in other private plans but with pooled risk.[185]

### B. Individual Account Plan

This two-part plan attempts to bring Social Security into long-term balance by cutting benefits and adding a defined contribution.[186]

---

180. *See id.* at 126.

181. Martin Feldstein, *Privatizing Social Security: The $10 Trillion Opportunity*, THE CATO PROJECT ON SOCIAL SECURITY PRIVATIZATION, No. 7 (Jan. 31, 1997) <http://www.cato.org/pubs/ssps/ssp7.hmtl> (discussing the need of Social Security reform in order to spur economic growth and raise real wages).

182. *See* REPORT I, *supra* note 18, at 77. Conservative advocates continue to support the current system and policies with minor adjustments, arguing that privatization proposals fail to understand the fundamental purpose behind social welfare programs. *See* Richard C. Leone, *Stick with Public Pensions*, FOREIGN AFF., Aug. 1, 1997, at 39, 40. Because privatization depends on market success, individual beneficiaries are left without a safety net to deal with market risk, wealth inequality, sluggish wage growth, and the uncertainty of life expectancy in retirement planning. *See id.* at 48. Moreover, private investments are not indexed for inflation; indexing is a major source of income protection under the current system. *See id.* at 49. Other countries that endeavored to privatize old-age benefit systems are often offered as a model for the United States. However, Britain's recent transition to privatization demonstrated that this approach does not necessarily save public money. *See generally id.* at 42-43. Likewise, the Chilean privatization was conceived in the midst of a political infrastructure dramatically different than that of the United States. *See id.* at 45-48 (discussing the imposition of privatization by military regime after national labor unions had been outlawed).

183. *See* REPORT I, *supra* note 18, at 77.

184. *See id.* at 78.

185. *See id.* at 85. *See generally The Future of Social Security for This Generation and the Next: Hearing Before the Subcomm. on Soc. Sec. of the House Comm. on Ways & Means*, 105th Cong. (1997), *available in* 1997 WL 11234670 (statement of U.S. Representative Earl Pomeroy, Democrat, North Dakota, urging caution and maintenance of Social Security's basic safety nets which is consistent with the MB plan approach).

186. *See State of the U.S. Economy: Hearing Before Senate Budget Comm.*, 105th Cong. (1997), *available in* 1997 WL 32750, at *4 (statement by Edward M. Gramlich,

This plan will help boost the capacity of the economy to support future retirees because future benefits will be financed through existing taxes, as compared to the current pay-as-you-go regime.[187] However, this plan will entail approximately a 30% decrease in benefits. This reduces the degree to which retirees can depend on Social Security to replace earnings upon retirement.[188] In addition to the benefit reduction, there will be a mandatory 1.6% payroll tax to be paid into the individual account.[189] The increased rate of return from this mandatory contribution, however, is estimated to offset the mandated reduction in benefits.[190]

Similar to the MB plan investment proposal, this option also provides for less individual control over investments and raises market concentration and governance concerns.[191] Workers will be required to invest a fixed amount of earnings in one or more preselected funds with no freedom to reduce contributions, to stop making contributions, or to reallocate them to privately managed investments.[192] In short, the government will hold and manage the assets in the individual accounts while individuals may select from a predetermined list of investment options.[193] Presumably, a narrow range of investment options will be offered including equity and bond index funds.[194]

This plan provides for partial advanced funding such that 40% of individual account assets will be invested in equities and 60% in fixed income over the seventy-five-year measurement period.[195] Utilizing this investment strategy, the IA approach will result in an estimated positive balance of $750 billion.[196]

The IA plan places prudent restrictions on the management of individual accounts by restricting investment choices to predeter-

---

Dean, School of Public Policy, The University of Michigan, Chair, 1996 Quadrennial Advisory Council on Social Security); REPORT I, *supra* note 18, at 155.

187. *See* REPORT I, *supra* note 18, at 62.

188. *See id.*

189. *See id.*

190. *See id.*

191. *See generally id.*

192. *See generally Personal Savings*, *supra* note 71 (statement by Carolyn L. Weaver, Ph. D., Director, Social Security and Pension Studies, American Enterprise Institute, discussing IA plan drawbacks).

193. *See* REPORT I, *supra* note 18, at 28.

194. *See generally Personal Savings*, *supra* note 71 (statement by Carolyn L. Weaver, Ph. D., Director, Social Security and Pension Studies, American Enterprise Institute, discussing IA plan drawbacks).

195. *See generally* REPORT I, *supra* note 18, at 129-31.

196. *See id.* at 53.

mined government-managed index funds.[197] However, there are other risks associated with the shift from a defined-benefits plan to a defined-contribution plan, such as the possibility of widespread abuses and imprudent investment choices.[198]

Also, the IA plan will have an immediate positive effect on the budget deficit.[199] This positive effect is due to the initial reduction in benefits and increase in taxation of benefits.[200] The IA plan is financed using a mandatory 1.6% of payroll tax. However, because this tax is a payroll tax, the revenues generated are completely outside the budget and, therefore, have no effect on the budget deficit.[201] Moreover, proponents argue that under the IA plan, the outstanding federal debt will be consistently reduced throughout the projection period.[202]

Drawbacks of the IA plan include harsh effects on low-income workers and the disabled.[203] The additional mandatory 1.6% payroll tax could be used to satisfy the immediate living needs of individuals, but instead will be diverted to their individual account. Moreover, lower-income individuals will reap less benefits from this particular scheme because they will be investing only modest amounts of money.

Furthermore, in theory, principal and income in individual accounts will be made available only upon retirement.[204] However, participants may be pressured to use IA funds for medical, housing, education, and other immediate needs.[205] In such cases, this plan will work primarily to the detriment of low-income workers because they may be permitted to deplete what little retirement resources they have accrued.[206] As a result, future Congresses may be lobbied to change the provisions protecting IA funds until retirement.[207]

The IA plan requires annuitization upon retirement. Under this annuitization, the real value of benefits is preserved under inflation, much like the inflation protection that the current system provides.[208]

---

197. *See id.* at 156.
198. *See id.*
199. *See id.* at 51.
200. *See id.*
201. *See id.*
202. *See id.*
203. *See id.* at 64.
204. *See id.*
205. *See id.*
206. *See id.*
207. *See id.*
208. *See id.* at 157.

However, the annuity provision poses a serious problem because private annuities generally do not offer fair rates of return.[209] Today, private annuities lack inflation protection and premiums tend to be very high.[210] Moreover, women will find it particularly burdensome to find a private annuity providing a fair rate of return. Because women tend to live longer, they will require returns to be paid out over longer periods of time than men.[211]

Some experts argue that the IA plan may disrupt existing pension arrangements[212] because Social Security as the basis of retirement planning will be fundamentally altered.[213] Pension bargaining could once again become a major source of labor dispute.[214] Labor unions, in particular, will want to retain the substantial equivalent of the defined benefits provided under the existing Social Security structure.[215]

Despite the drawbacks, proponents of the IA plan claim that such a system will increase national savings by investing funds in equities, while at the same time, causing no budgetary imbalances.[216] Moreover, the plan provides for prudent, effective management of funds while protecting workers by requiring annuitization. There are no transition costs because funds are collected and designated to individual accounts without the need to micromanage on an account-to-account basis as compared to the PSA plan.[217]

### C. Personal Security Account Plan

Although this plan provides for more individual control of Social Security retirement assets, a considerable amount of risk is allocated to the individual investor. "[I]nstead of the trust fund making

209. *See id.* at 71.
210. *See id.*
211. *See id.*
212. *See generally* Gerald Cole, *Caught Between Demographics and the Deficit: How Can Retirement Plans Meet the Challenges Ahead? Rethinking the Corporate Retirement Commitment*, COMPENSATION & BENEFITS REV., Jan. 11, 1996, at 32 (discussing current corporation benefits and pension programs).
213. *See* REPORT I, *supra* note 18, at 65.
214. *See id.*
215. *See id.*
216. *See id. See generally Status*, *supra* note 30 (statement by Beau Boulton, Legislative Counsel for United Seniors Association); *Future of Social Security: Hearings on the Future of Social Security for This Generation and the Next Before the Subcomm. on Soc. Sec. of the Senate Comm. on Ways & Means*, 105th Cong. (1997), *available in* 1997 WL 11234133 (statement by Stephen Moore, Director of Fiscal Policy Studies, Cato Institute, making the case for privatization); Martin S. Feldstein, *The Case for Privatization: Social Security System (Supporting Retirees I)*, FOREIGN AFF., July 1997, at 24.
217. *See* REPORT I, *supra* note 18, at 156.

the investments and thereby pooling the risk, the risk of investing . . . [is placed] on individual retirees."[218] Although retirees are projected to earn desirable rates of return, estimations of private market earnings under this proposal "are based on averages, . . . [meaning that] not all investors [will] earn average returns."[219] Thus, those investors not earning average returns are likely to become dependent on first-tier benefits which are equivalent to only two-thirds of the poverty line.[220] In 1996, this figure amounted to about $400 per month.[221]

The first tier of benefits is redistributive in nature such that the worker who earns minimum wage and the worker that earns four times minimum wage (and pays four times the taxes) will receive the same benefit.[222] Actuarial estimations suggest "that average earners . . . [will] not gain income from the PSA plan and low wage workers . . . [will] gain only marginally."[223] High-wage earners will fair better because higher earners will invest more and their investments will in turn earn more.[224] Low-wage earners would not be affected as much as mid-range earners because of the redistributive effect of the first tier of benefits.[225] As a result, mid-range earners will bear much "risk with little likelihood of gain."[226]

Although the Council agrees that Social Security should remain redistributive in nature, critics of the PSA plan argue that it is too

218. *Social Security's Future: Hearing Before the Subcomm. on Soc. Sec. & Family Policy of the Senate Fin. Comm.*, 104th Cong. (1996), *available in* 1996 WL 7137338, at *4 (statement of Edith U. Fierst, Member, 1994-95 Advisory Council on Social Security). For a discussion of risk, see *Future of Social Security, Hearing Before the Subcomm. on Soc. Sec. of the House Comm. on Ways & Means*, 105th Cong. (1997), *available in* 1997 WL 133728, at *9 (statement of Sylvester J. Schieber, Vice President, Watson Wyatt Worldwide).

219. *Social Security's Future: Hearing Before the Subcomm. on Soc. Sec. & Family Policy of the Senate Fin. Comm.*, 104th Cong. (1996), *available in* 1996 WL 7137338, at *4 (statement of Edith U. Fierst, Member, 1994-95 Advisory Council on Social Security).

220. *See id.*

221. *See id.; see also Social Security Advisory Council Report, Hearing Before the Subcomm. on Soc. Sec. & Family Policy of the Senate Fin. Comm.*, 104th Cong. (1996), *available in* 1996 WL 10829686, at *18-20 (statement of Sylvester J. Schieber, Vice President, Watson Wyatt Worldwide, outlining Trust Funds and PSA balances at selected years).

222. *See Personal Savings, supra* note 71, at *14 (statement of Carolyn L. Weaver, Director, Social Security and Pension Studies, American Enterprise Institute).

223. *Social Security's Future: Hearing Before the Subcomm. on Soc. Sec. & Family Policy of the Senate Fin. Comm.*, 104th Cong. (1996), *available in* 1996 WL 7137338, at *5 (statement of Edith U. Fierst, Member, 1994-95 Advisory Council on Social Security).

224. *See id.*

225. *See id.*

226. *Id.*

redistributive.[227] For instance, the flat benefit is the same for all retirees irrespective of level of contribution.[228] If a worker earned just over $2500 a year in 1996, that worker would be eligible for flat benefits while higher-wage earners paying much more into the system would receive that same flat benefit.[229] Accordingly, the fact that benefits are wholly unrelated to contribution rates may be met with serious public opposition.[230]

Next, the PSA plan presents the risk of private market scandals. Social Security payments have always been made on time without scandal.[231] This is not true of private markets where there have been insider trading scandals, the savings and loan fiascos, and, most recently, reports of employers not investing employees' 401(k) withheld earnings.[232]

Proponents of the PSA plan proposed safeguards to minimize some potential problems. The Council proposed the appointment of two different advisory groups. The first group would make investment decisions and monitor investment performance.[233] The second advisory group would determine the appropriate action to be taken when those companies which are most vital to Social Security are the subject of hostile takeovers, or have managment or other corporate governance problems.[234]

The PSA plan faces numerous other obstacles. For example, the PSAs will be impossible to regulate effectively because they will be administered by several small financial institutions across the country

---

227. *See* REPORT I, *supra* note 18, at 71.

228. *See id.*; *see also Future of Social Security: Hearing Before the Subcomm. on Soc. Sec. of the House Comm. on Ways & Means*, 105th Cong. (1997), *available in* 1997 WL 133728, at *9 (statement of Sylvester J. Schieber, Vice President, Watson Wyatt Worldwide, discussing investment risk).

229. *See* REPORT I, *supra* note 18, at 71. *See generally Social Security Advisory Council Report: Hearing Before the Subcomm. on Soc. Sec. & Family Policy of the Senate Fin. Comm.*, 104th Cong. (1996), *available in* 1996 WL 10829686 (statement of Sylvester J. Schieber, Vice President, Watson Wyatt Worldwide, discussing intergenerational equity and rate of return on investment).

230. *See* REPORT I, *supra* note 18, at 71.

231. *See generally Social Security's Future: Hearing Before the Subcomm. on Soc. Sec. & Family Policy of the Senate Fin. Comm.*, 104th Cong. (1996), *available in* 1996 WL 737338 (statement of Edith U. Fierst, Member, 1994-95 Advisory Council on Social Security).

232. *See id.*; *see* Kaplan, *supra* note 28, at 199.

233. *See Social Security's Future: Hearing Before the Subcomm. on Soc. Sec. & Family Policy of the Senate Fin. Comm.*, 104th Cong. (1996), *available in* 1996 WL 7137338, at *3 (statement of Edith U. Fierst, Member, 1994-95 Advisory Council on Social Security).

234. *See id.*

and can be dispersed for nonretirement purposes.[235] Furthermore, under the PSA proposal, it will be difficult to ensure that contributions are (1) actually invested; (2) invested as the worker wishes; and (3) that the investments stay invested.[236] Situations involving small employers are particularly difficult because of the complicated nature of the PSA process.[237] For instance, first the employer will withhold contributions.[238] Next, these funds will be forwarded to a bank, investment broker, or investment institution.[239] Finally, the financial institution in question will report any changes in investment or earnings to the IRS.[240] In short, the structure will be complex and difficult to regulate, providing considerable opportunity for abuse.[241]

The complexity of the PSA plan is extremely relevant because seventy-five million Americans have never invested.[242] Some Americans may not be sophisticated enough to make the necessary choices.[243] The SEC's mandatory disclosure policy aims at protecting investors, but investors must possess some level of sophistication in order to read corporate reports and understand their implications.[244] Nonetheless, many financial analysts are not convinced that Americans lack the ability to make wise investment decisions.[245]

The investment industry is likely to benefit a great deal in moving from the current system to one in which contributions are invested in private equities. Accordingly, agency fees associated with investment advisers, mutual funds, and stock brokers may diminish a large portion of the earnings from equities because these institutions will exact substantial fees for their services.[246] Council members have suggested capping agency fees.[247] However, the capping of fees does not have general Council support because members are not entirely con-

235. *See* REPORT I, *supra* note 18, at 156-57.
236. *See id.*
237. *See id.*
238. *See id.* at 74.
239. *See id.*
240. *See id.*
241. *See id.*
242. *See Social Security's Future: Hearing Before the Subcomm. on Soc. Sec. & Family Policy of the Senate Fin. Comm.*, 104th Cong. (1996), *available in* 1996 WL 7137338, at *6 (statement of Edith U. Fierst, Member, 1994-95 Advisory Council on Social Security).
243. *See id.*
244. *See id.*
245. *See id.*
246. *See Personal Savings*, *supra* note 71, at *29.
247. *See id.*

vinced that the problem of fees is sufficiently severe to warrant government intervention.[248]

Should the PSA plan be implemented, 127 million workers under the age of fifty-five will invest $150 billion per year.[249] Workers earning less than $28,000 per year are more at risk under this proposal as compared to higher-wage earners.[250] Not only do these workers lack experience in investing, but studies show that individuals in this income bracket take a conservative approach to investing, ultimately yielding low rates of return.[251] More importantly, the amounts available to invest by these individuals are relatively small, approximately $1000 per year.[252] As a result, a large portion of assets are consumed by investment expenses and fees.[253]

Also, the PSA plan does not require retirees to annuitize upon retirement. As a result, retirees could outlive their investments. Even if retirees were required to annuitize, those who retire in a bear market may be unable to buy adequate annuities.[254] As a result, the current confidence in the Social Security system may be replaced by uncertainty with respect to anticipated retirement dates and insecurity regarding available income upon retirement.[255]

Although the PSA plan permits investment in any generally available financial instrument, individuals are provided full access to funds at age sixty-two with no requirement to annuitize or to provide support for spouses or dependents.[256] This type of access provides a

---

248. *See id.*

249. *See* REPORT I, *supra* note 18, at 72.

250. *See id.*

251. *See id.*

252. *See id.* at 72-73.

253. *See id.*

254. *See Social Security's Future: Hearing Before the Subcomm. on Soc. Sec. & Family Policy of the Senate Fin. Comm.*, 104th Cong. (1996), *available in* 1996 WL 7137338, at *3 (statement of Edith U. Fierst, Member, 1994-95 Advisory Council on Social Security).

255. *See id.; see also Social Security Advisory Council Report: Hearing Before the Subcomm. on Soc. Sec. & Family Policy of the Senate Fin. Comm.*, 104th Cong. (1996), *available in* 1996 WL 404977, at *6-7 (statement of Sylvester J. Schieber, Vice President, Watson Wyatt Worldwide, discussing public confidence).

256. *See* REPORT I, *supra* note 18, at 66, 157. *See generally Social Security Advisory Council Report, Hearing Before the Subcomm. on Soc. Sec. of the House Comm. on Ways & Means*, 105th Cong. (1997), *available in* 1997 WL 11234134 (statements of Kelly Olsen, Research Analyst, Employee Benefit Research Institute and Paul J. Yakoboski, Senior Research Associate, Employee Benefit Research Institute, discussing annuitization of retirement benefits).

mixed message to workers—we don't trust you to save when you are young but when you are sixty-two, it's all yours.[257]

The PSA plan does require that the account be held until retirement, but a legislative exception could be made for medical, educational, housing, and unemployment expenses.[258] In the event of a legislative exception, many participants may exhaust PSA funds and be left only with the flat benefit upon retirement.[259] Naturally, when disasters such as unemployment or illness happen, individual owners will want to obtain the PSA funds. Congress will need to resist the temptation to permit this kind of exception in order to prevent workers from retiring with inadequate resources and ultimately ending up on the public dole.[260]

Council members supporting the PSA plan urge that access restrictions like those in the IA plan are excessive, preventing only a few workers from making costly mistakes, but prohibiting all workers from making profitable investments.[261] For instance, the IA plan forces annuitization regardless of other sources of income, life expectancy, and medical and family needs in order to prevent depletion of assets.[262] Likewise, such restrictions also prevent workers from bequeathing their wealth to their heirs.[263]

Another drawback of this plan is that spousal and survivor benefits are not payable from PSAs.[264] Instead, a married couple will be entirely dependent on the PSA balance for benefits above the first tier, which may or may not be sufficient for the lower-wage-earner spouse.[265] Therefore, further detailed regulations will be necessary; otherwise, one wage earner could squander the entire PSA on herself,

---

257. *See* REPORT I, *supra* note 18, at 157.

258. *See id.* at 70.

259. *See id.* at 71.

260. *See Social Security's Future: Hearing Before the Subcomm. on Soc. Sec. & Family Policy of the Senate Fin. Comm.*, 104th Cong. (1996), *available in* 1996 WL 7137338, at *4 (statement of Edith U. Fierst, Member, 1994-95 Advisory Council on Social Security).

261. *See* REPORT I, *supra* note 18, at 129.

262. *See id.*

263. *See id.*

264. *See Social Security's Future: Hearing Before the Subcomm. on Soc. Sec. & Family Policy of the Senate Fin. Comm.*, 104th Cong. (1996), *available in* 1996 WL 7137338, at *3 (statement of Edith U. Fierst, Member, 1994-95 Advisory Council on Social Security).

265. *See id.*

leaving the lower-wage-earner spouse entirely dependent on the first tier of benefits.[266]

This reform proposal takes a very different approach to spousal, survivor, and dependent benefits as compared to the traditional approach. First, the PSA proposal provides no benefits for nonworking spouses or survivors, other than the flat benefit, unless there is a child of the wage earner in the care of the surviving spouse.[267] In such cases, the nonworking spouse is entitled to $205 per month, half of the flat benefit. This benefit increases to $461 a month after the wage-earning spouse's death, at which time the surviving spouse could receive up to $615 a month if that spouse accrued his or her own benefits.[268] As a result, surviving spouses will not be protected against poverty.[269]

Moreover, spouses do not have any rights to accumulated funds or to receive information about the fund.[270] This could result in unnecessary spousal tension and, even worse, financial abandonment.[271] In comparison, ERISA and public pension plans for federal employees require spousal access and knowledge unless specifically waived by the nonparticipating spouse.[272] PSA restrictions leave spouses in the precarious position of negotiating or litigating with respect to accumulated retirement funds.[273]

More importantly, upon divorce such assets will be divided on a case-by-case basis where divorce attorneys will benefit from the division of basic retirement benefits.[274] The instance of divorce is rarely an issue under today's Social Security system.[275] Under the current sys-

266. *See id.*

267. *See* REPORT I, *supra* note 18, at 72.

268. *See id.*; *see also Social Security Advisory Council Report: Hearing Before the Subcomm. on Soc. Sec. & Family Policy of the Senate Fin. Comm.*, 104th Cong. (1996), *available in* 1996 WL 134461, at *10 (statement of Sylvester J. Schieber, Vice President, Watson Wyatt Worldwide, analyzing spousal benefits).

269. *See* REPORT I, *supra* note 18, at 72. Today, 22% of nonmarried women live below the poverty line. *See id.* Will the PSA plan make these statistics worse? *See id.* at 72. Are we, as a nation, willing to take that chance?

270. *See id.*

271. *See id. See generally Status of Social Security and Medicare Trust Funds: Hearing Before the Subcomm. on Soc. Sec. of the House Comm. on Ways & Means*, 105th Cong. (1997), *available in* 1997 WL 11233050 (statement of Deborah Briceland-Betts, Executive Director, Older Women's League, opposing privatization and emphasizing the importance of the social insurance function of Social Security for women).

272. *See* REPORT I, *supra* note 18, at 72.

273. *See id.*

274. *See id.*

275. *See Future*, *supra* note 57, at *8.

tem, if a marriage lasts more than ten years, auxiliary benefits will be payable to the lower-earning spouse without reduction in benefits to the higher-earning spouse.[276] In contrast, PSA accounts become assets upon divorce, to be divided in accordance with differing state laws. In the divorce proceedings, one spouse may lose rights to the accumulated funds or the earnings could be consumed by litigation costs.[277]

Other drawbacks of the PSA plan include the lack of COLAs and the plan's treatment of the disabled. Today, COLAs are payable under Social Security to assure the buying power of a Social Security benefit is not diminished by inflation.[278] Likewise, disabled Americans have lower incomes than average retirees and are less likely to have supplemental private savings or pensions.[279] The disabled rely heavily on Social Security for a large part of their retirement incomes because their careers often have been cut short and they face additional disability-related expenses.[280]

The PSA plan provides that disability benefits will decrease across the board, concurrent with the increase of normal and early retirement ages.[281] Disability benefits will be reduced by 13% by 2014, and 20% by 2038 until benefits are ultimately reduced by 30%.[282] This segment of the population is particularly vulnerable and dependent and unlikely to have accumulated private savings.[283]

Equally important to the reduction of disability benefits is the PSA plan's potential effect on organized labor. A drastic move to a system of PSAs will necessitate a change in current pension integration rules and other related regulations.[284] Bargaining over pensions could once again become the focus of labor disputes, as unions bargain to recover a substantial equivalent of the unique features offered

276. *See* Kaplan, *supra* note 28, at 202-06.

277. *See Future*, *supra* note 57.

278. For a detailed description of the current Social Security structure, see Kaplan, *supra* note 28, at 207-08, and *Future*, *supra* note 57, at *9.

279. *See* REPORT I, *supra* note 18, at 64.

280. *See id.*

281. *See id.* at 72; *see also The Future of Social Security for This Generation and the Next: Hearing Before the Subcomm. on Soc. Sec. of the House Comm. on Ways & Means*, 105th Cong. (1997), *available in* 1997 WL 383801, at *14 (statements of Representatives Charles W. Stenholm and Jim Kolbe, Co-Chairs, House Public Pension Reform Caucus, discussing the importance of considering the special needs of minorities, women, and low-income groups).

282. *See* REPORT I, *supra* note 18, at 72.

283. *See id.*

284. *See id.* at 73.

under the current Social Security structure such as inflation protection, disability insurance, and dependent protection.[285]

Under the PSA plan, tremendous transition costs are unavoidable because the fundamental structure of Social Security as a pay-as-you-go system will be changed to a fully funded system.[286] Society will, in effect, be paying twice for retirement. The program will have to generate sufficient funds to provide benefits to those already retired and to those who have already accrued rights under the current system, as well as to cover the cost of establishing the new system.[287]

Under the PSA proposal, present beneficiaries are treated more favorably because current workers and future beneficiaries will bear the cost of transition in order to bring the system into long-term balance.[288] This type of approach is wrought with inequality and unlikely to survive the strict scrutiny of Congress.[289] Moreover, transition costs for the PSA plan include a prolonged increase in taxation and massive borrowing from the Treasury.[290] Specifically, the payroll tax will increase from 12.4% to 14% for the next seventy years.[291] At the same time the program will borrow $150 billion from the Treasury over the next ten years to be paid off over a forty-year period.[292] Massive borrowing of this kind not only tends to be politically unpopular, but is also economically unwise.[293]

The PSA plan also entails significant administrative costs. The PSAs will be managed account by account creating substantial administration costs because records will be kept for every small account. In comparison, the IA plan entails low administration costs because the

---

285. *See id.*

286. *See id.* at 66, 68; *see also Social Security Advisory Council Report: Hearing Before the Subcomm. on Soc. Sec. & Family Policy of the Senate Fin. Comm.*, 104th Cong. (1996), *available in* 1996 WL 404977, at *12-15 (statement of Sylvester J. Schieber, Vice President, Watson Wyatt Worldwide, analyzing transition costs).

287. *See* REPORT I, *supra* note 18, at 66, 68.

288. *See id.* at 69.

289. *See id.*

290. *See id.* at 156. *See generally Future of Social Security for This Generation and the Next: Hearing Before the Subcomm. on Soc. Sec. of the House Comm. on Ways & Means*, 105th Cong. (1997), *available in* 1997 WL 345165 (statement of Stephen Moore, Director of Fiscal Policy Studies, CATO Institute, advocating privatization as a permanent solution to the increasing ratio of retirees to workers).

291. *See* REPORT I, *supra* note 18, at 68.

292. *See id.* at 156.

293. *See id.*; *see also Future of Social Security: Hearing Before the Subcomm. on Soc. Sec. of the House Comm. on Ways & Means*, 105th Cong. (1997), *available in* 1997 WL 133728, at *9 (statement of Sylvester J. Schieber, Vice President, Watson Wyatt Worldwide, discussing debt).

contributions will be collected by the government and allocated to the IAs, with large checks being sent to money managers.[294]

The PSA plan also entails an unprecedented taxation scheme that will no doubt require extensive expert analysis to develop.[295] Under this approach, accumulated funds will be tax exempt because the original contributions are made with after-tax income.[296] Under current tax law, all investments made with after-tax dollars are subject to taxation on the return or capital gain from that investment.[297] However, because contributions are taxable, there will be no initial loss of tax revenues by the federal government, rather the tax loss will be spread out over time as untaxed earnings on investments are paid out.[298] From a practical standpoint, taxation in this manner will not affect the federal budget immediately, but over time the practice will affect the budget.[299]

This taxation scheme makes the plan appear more attractive at the onset because tax revenues will pour in initially from contribution taxation. However, lack of revenue from subsequent taxation may necessitate an increase in payroll taxes to sustain the tax-exempt status.[300] These types of tax shelter investments are initially appealing but may prove costly and unsustainable over time.[301] Moreover, Advisory Council members were not chosen for their taxation acumen and are not in the position to develop a major change in the tax code. Accordingly, a proposal of such magnitude will need to be evaluated by tax experts.[302]

In summary, the PSA plan changes the fundamental structure of Social Security from a defined-benefits plan to a defined-contribution plan. It trades manageable problems under the current system for a wide range of new problems including paying twice for retirement,

---

294. *See* REPORT I, *supra* note 18, at 157.

295. *See* REPORT I, *supra* note 18, at 69; *see also Social Security Advisory Council Report: Hearing Before the Subcomm. on Soc. Sec. & Family Policy of the Senate Fin. Comm.*, 104th Cong. (1996), *available in* 1996 WL 134461, at *10-12 (statement of Sylvester J. Schieber, Vice President, Watson Wyatt Worldwide, analyzing the taxation of benefits).

296. *See* REPORT I, *supra* note 18, at 69. Compare this practice with that of the 401(k) where the original investment and earnings are initially tax free. *See id.* Therefore, upon cashing in, all funds are taxable. *See id.*

297. *See id.*

298. *See id.*

299. *See id.*

300. *See id.*

301. *See id.*

302. *See id.*

increased taxation, and an increase in the federal budget deficit.[303] The PSA proposal represents a fundamental shift in policy from protecting against individual risk to exposing individuals, disabled persons, and the young to substantial risk in retirement security.[304] Furthermore, this plan provides no inflation protection and provides inadequate protection for surviving spouses and the disabled, while at the same time introducing an unprecedented taxation scheme.[305]

## IV. Recommendation

As the proposals demonstrate, many competing values drive the effort to reform Social Security. Before deciding which plan or combination of provisions best achieves reform, policy makers must examine the policies upon which Social Security was established. Policy makers must determine which proposal or combination of provisions preserves the basic values and policies underlying the inception of the Social Security program while keeping costs within manageable limits.

The Social Security Act of 1935[306] is a proclamation of social policy. This Act mandated an expanded public policy for dealing with the problems of retirement, disability, and childhood dependency, built on the principle of pooled risk.[307] This program was both radical and conservative for its time.[308] Since the enactment of Social Security in 1935, the primary function has been to protect workers and depen-

---

303. *See id.* at 76. For a thorough mathematical analysis of the PSA plan, see generally *Social Security Advisory Council Report: Hearing Before the Subcomm. on Soc. Sec. & Family Policy of the Senate Fin. Comm.*, 104th Cong. (1996), *available in* 1996 WL 134461 (statement of Sylvester J. Schieber, Vice President, Watson Wyatt Worldwide).

304. *See* REPORT I, *supra* note 18, at 76-77. *See generally Future of Social Security: Hearing Before the Subcomm. on Soc. Sec. of the House Comm. on Ways & Means*, 105th Cong. (1997), *available in* 1997 WL 11234851 (statement of Nick Smith, Congressman from Michigan, advocating privatization and discussing the necessity of pilot testing).

305. *See* REPORT I, *supra* note 18, at 76. For a thorough mathematical analysis of the PSA plan, see generally *Social Security Advisory Council Report: Hearing Before the Subcomm. on Soc. Sec. & Family Policy of the Senate Fin. Comm.*, 104th Cong. (1996), *available in* 1996 WL 134461 (statement of Sylvester J. Schieber, Vice President, Watson Wyatt Worldwide).

306. Social Security Act of 1935, Pub. L. No. 74-271, ch. 531, 49 Stat. 620 (codified as amended in scattered sections of 42 U.S.C.).

307. *See* Wilbur J. Cohen, *The Development of the Social Security Act of 1935: Reflections Fifty Years Later*, 6 SOC. SECURITY REP. SERVICE 933, 960-61 (1984).

308. *See id.* at 960-61.

dents from certain economic risks.[309] President Roosevelt, addressing Congress on June 8, 1934, promised legislation to restore security. He stated:

> Among our objectives I place the security of men, women, and children of the nation first . . . . [W]e . . . undertake the great task of furthering the security of the citizen and his family through social insurance . . . [which is] a sound means . . . to provide at once security against several of the great disturbing factors of life . . . .[310]

Since its inception, Social Security operated as a self-supporting and highly effective program with low administrative costs.[311] However, long-term demographic shifts in the number of retirees threaten the stability of the program. Many aspects of the proposed reform plans, and the proposals taken as a whole, are dramatic departures from the social insurance principle of public policy espoused by President Roosevelt. Consistent with Roosevelt's social insurance concept, the key to reform is to maintain the redistributive nature of Social Security, while providing adequate benefits at minimal risk. The Social Security program is not a get-rich-quick investment vehicle, but rather a social insurance system that protects individuals against certain economic losses and provides for retirement with dignity. Reform should maintain Social Security's social insurance role, which means that the program should continue providing low-income retirees with proportionally higher benefits, and the disabled and survivors of deceased workers with insurance.[312] Accordingly, policy makers must realize that redistribution is a unique function requiring public financing and control and cannot be achieved through private investment and control.[313]

The PSA and IA plans represent a fundamental shift in the approach to Social Security. More importantly, the approach taken by the Social Security Advisory Council in developing these proposals is

309. *See* Herman Grundmann, *Section I: Social Insurance Programs*, 56 SOC. SEC. BULL., Winter 1993, at 6, 6.

310. Message to the Congress Reviewing the Broad Objectives and Accomplishments of the Administration (June 8, 1934), *in* THE PUBLIC PAPERS AND ADDRESSES OF FRANKLIN D. ROOSEVELT 287, 288-93 (Samuel I. Rosenman comp., 1938).

311. *See Future of Social Security: Hearing on the Report of the Advisory Council on Social Security, Subcomm. on Soc. Sec. of the Comm. on Ways & Means*, 105th Cong. (1997), *available in* 1997 WL 8220142, at *4 (statement of Robert M. Ball).

312. *See* Calmes, *supra* note 128, at A2.

313. *See An International Perspective on Reforming Social Security: Hearing Before the Senate Special Comm. on Aging*, 104th Cong. (1996), *available in* 1996 WL 13104211, at *6 (written testimony of Estelle James, Lead Economist, Policy Research Department, World Bank).

fundamentally flawed in that Social Security is not considered as a means of preserving human dignity, but rather is presumed to be a wholly economic endeavor.[314] Rather than developing and evaluating reform in terms of social protection for beneficiaries, Council members who support these two plans focused on the criteria used to measure performance of private investment and insurance programs.[315] In moving toward reform, the social insurance dimension of Social Security must be paramount while the economic dimension of Social Security must remain merely "the tool used to achieve human dignity and not an aim in itself."[316]

In contrast to this social insurance principle, the IA plan entails increased payroll deductions, creating an unstable environment whereby participants will shift funds from Social Security to private plans. The IA plan weakens the basis of the retirement system by shifting from a defined-benefits program in which benefits are determined by law, to a defined-contribution program in which benefits are determined by individual investment choice and market performance.[317] Furthermore, this plan is particularly harsh on low-income workers because participants are required to set aside an additional portion of wages solely for the purpose of retirement.[318] Likewise, benefit cuts are particularly harsh for the disabled.[319] At the same time, national retirement savings will not necessarily be increased because funds may be made available for other purposes.[320]

The PSA plan also changes the basis of Social Security from a defined-benefit to a defined-contribution plan.[321] This plan introduces an array of problems in place of the relatively few manageable problems associated with the current system.[322] Such problems include increased taxation and borrowing, as well as an unprecedented taxation scheme. Likewise, this plan lacks inflation protection and annuitization requirements and provides inadequate protection to spouses, survivors, and disabled persons.[323]

---

314. *See* Ben-Israel, *supra* note 38, at 175.
315. *See id.*
316. *Id.*
317. *See* REPORT I, *supra* note 18, at 65.
318. *See id.*
319. *See id.*
320. *See id.*
321. *See id.* at 76.
322. *See id.*
323. *See id.*

In sharp contrast, the MB plan preserves the values embodied in the Social Security Act of 1935. The key to this plan is achieving financial integrity from various existing sources while ensuring the adequacy of benefits. The Social Security system remains a defined-benefits program in which benefits are determined by law rather than by individual investment choices under a shared-risk scheme. However, proponents realize that increased taxes and decreased benefits alone are insufficient to solve the long-term insolvency of the Social Security program. Therefore, members suggest privatization of a portion of assets as a possible option after extensive evaluation and study is conducted. In sum, Social Security as a social insurance program remains substantially intact under the MB plan with the possibility of pursuing the benefits of higher private market returns with manageable risk.

## V. Conclusion

The financial exhaustion of the current Social Security system is imminent. As such, policy makers will be forced to make changes to the existing system. There are difficult choices ahead; changes must be made. Previous attempts at increasing taxes and decreasing benefits have consistently failed to bring about a lasting solution. Legislators are now presented with three proposals ranging from conservative to radical, which will require extensive debate and analysis. The decision for reform will require a balancing of economic considerations and public policy.

How will policy makers reconcile these competing proposals and strike an appropriate balance? Compassion compelled the inception of the Social Security program. As such, proposals for reform should be examined with that same compassion as a guiding principle. The Maintain Benefits plan seems to reform Social Security while maintaining the general principles upon which the program was built. Dignity in retirement and security for spouses, dependents, and disabled persons should be the standard by which reform proposals are evaluated rather than in terms of investment performance and economic yield.