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SOCIAL SECURITY COMMISSION PROPOSALS CONTAIN SERIOUS WEAKNESSES BUT MAY IMPROVE THE DEBATE IN AN IMPORTANT RESPECT

by Robert Greenstein

The Social Security plans that the Social Security commission approved at its final meeting on December 11 have significant weaknesses. Nevertheless, the plans may serve one important purpose. The Commission's plans demonstrate the emptiness of rhetoric that pictures individual accounts as a painless way to restore Social Security solvency without making hard choices regarding reductions in Social Security benefits, increases in payroll taxes, or deep cuts or tax increases elsewhere in the budget.

In recent years, a number of Members of Congress — as well as President Bush as a candidate — have presented individual accounts as a painless alternative to either benefit cuts or payroll tax increases in restoring Social Security solvency. These policymakers have claimed or implied that because individual accounts would be invested in assets that would provide a higher rate of return than the Treasury bonds in which Social Security reserves currently are invested, individual accounts were the way to restore long-term solvency without the benefit cuts or payroll tax increases that other approaches to restoring solvency would entail.

The Social Security Commission's report confirms what honest analysts, including a number of analysts who favor replacing part of Social Security with individual accounts, have been saying all along — namely, that the portrayal of individual accounts as a "free lunch" approach to restoring solvency is misleading and inaccurate. The Commission proposed three Social Security plans, all of which include individual accounts. One plan makes little progress in restoring solvency over the next 75 years. The other two plans are able to restore long-term solvency only because they contain a combination of substantial reductions in guaranteed Social Security benefits and the infusion of several trillion dollars in general revenue from the rest of the budget.

With President Bush's own hand-picked commission of private-account proponents unable to find a way to restore solvency without large benefit cuts and the transfer of large sums from the rest of the budget to Social Security, the media and the public at large should be suspicious of any future claims by policymakers or political candidates that private accounts are a "third way" that can restore long-term solvency without other painful actions. Those who promote proposals or make campaign promises to this effect should be treated with some skepticism; they should be asked to detail how their plans would be paid for. In the absence of specific means of paying for such a proposal or campaign promise, the proposal or promise should not be taken very seriously. With the Commission report demonstrating there is no "free lunch" here, it should be clear that those who continue to claim that individual accounts provide a painless way to restore Social Security solvency and represent an alternative to hard choices are engaging in rhetoric that, while politically expedient, is misleading.

Weaknesses of the Commission Plans

While the Commission report may have the beneficial effect just noted, the commission's three plans do exhibit significant weaknesses. These plans rely on large general revenue transfers from the rest of the budget but fail to explain how these transfers would be financed, a serious deficiency given that the rest of the budget has no revenue left to transfer. In the absence of these unspecified funding transfers, all three of the commission's plans actually would hasten the date of Social Security insolvency. In addition, the two plans that would restore long-term solvency with the help of these unspecified revenue transfers also rely on reductions in regular Social Security benefits that are sufficiently deep that they are unlikely to be acceptable to the public.

Also of concern, those same two plans would result in substantial benefit reductions for all beneficiaries, including the disabled. In the executive summary of the draft report, the Commission portrays its plans as protecting Social Security Disability Insurance. Only on page 144 of the Commission's 145-page report is it acknowledged that the benefit cuts in these plans would be applied in full to Social Security disability benefits as well. Since disabled individuals who cannot work cannot make payroll tax contributions to an individual account, these individuals would have little income from individual accounts to offset the large reductions in their Social Security benefits. As a result, the effect of applying the proposed benefit reductions to disability benefits would be devastating for millions of disabled Americans in future decades.

Each of these weaknesses in the Commission report is discussed below.

General Revenue Transfers

The Commission plans rely on the transfer in coming decades of vast sums from the rest of the budget to Social Security despite the fact that surpluses outside Social Security have disappeared. While insisting that its critics specify where the money would come from for courses they wish to pursue, the Commission fails to indicate how any of the general revenue transfers it includes in its plans would be financed. The Commission report essentially rests on a "magic asterisk" of unprecedented proportions.

In the absence of general revenue transfers, all three Commission plans would accelerate the year in which Social Security becomes insolvent, as a result of the diversion of payroll tax revenues from Social Security to individual accounts. Data in the Commission report show that without general revenue transfers, the year in which the Social Security Trust Fund would become insolvent would be accelerated from 2038 under current law to the 2020s under the Commission's plans.

Benefit Reductions

The plans that appear to restore long-term solvency contain deep reductions in traditional Social Security benefits, along with the large unspecified general revenue transfers referred to above. For example, Plan #2 proposes to change the way Social Security benefits are computed (by moving from "wage indexing" to "price indexing") in a manner that would result in steep Social Security benefit decreases. A worker who earns the average wage throughout his or her career and retired in 2040 would receive Social Security benefits 24 percent below what the current benefit formula would provide. An average wage-earner who retired in 2070 would face a benefit reduction in Social Security benefits of 43 percent, compared to what the current benefit structure would provide.[1]

This change would result in a sharp reduction in the percentage of pre-retirement earnings that Social Security replaces when a worker retires. Under current law, Social Security benefits would equal — or replace — 37 percent of the pre-retirement earnings of an average wage earner. Under this change, Social Security benefits would replace 28 percent of the pre-retirement earnings of an average wage-earner who retires in 2040 and just 21 percent of the pre-retirement earnings of an average wage-earner who retires in 2070. This benefit reduction would apply to all beneficiaries, not just to those electing to forgo some of their Social Security benefits in return for an individual account.

Disability Benefits

The various benefit reductions proposed — and in particular, the proposal to move from wage to price indexing, which is included in whole or in part in two of the Commission's three plans — would fully apply to Social Security disability benefits as well. This is not acknowledged until page 144 of the report. On that page, the report also admits that "DI beneficiaries with abbreviated work histories might have relatively low account balances," meaning that they would be subject to large Social Security benefit cuts but might receive little offsetting income from private accounts. (Furthermore, disabled individuals would be unable to receive *any* income from individual accounts to supplement their reduced Social Security disability benefits until they reached their 60s, since the Commission's report stipulates that no funds may be drawn from an individual account for any reason until the account-holder reaches retirement age.) This is one of the problems with the proposal to shift from wage indexing to price indexing — it is not feasible to make this change without applying this benefit cut to disability benefits as well.

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[1] See Kilolo Kijakazi and Robert Greenstein, "Replacing Wage Indexing with Price Indexing," Center on Budget and Policy Priorities, revised December 14, 2001.

The Commission report is less than straightforward on this matter. The report's summary presentation implies that Social Security Disability Insurance would be protected, which turns out to mean only that a Social Security Disability Insurance program will still exist, not that disability benefits will not be substantially reduced. Given the importance of this issue, the Commission should not have buried this matter on the next-to-last page of a dense 145-page report that few people will read through.

Survivor Benefits

It should be noted that the benefit reductions also would affect survivors' benefits. The Commission report includes a proposal that many experts have recommended in the past to improve Social Security benefits for elderly survivors by setting the benefit for a surviving spouse at 75 percent of what the couple would have received if both spouses were still alive. Under present law, a surviving spouse receives a benefit that equals 50 percent to 67 percent of the combined benefit the couple would have received.

Because of this proposal, the Commission report presents its proposals as increasing benefits for widows, a claim some reporters have uncritically accepted. The commission does not explain that combining this change with the benefit change described above that the Commission also is recommending — moving from wage indexing to price indexing — alters the impact on widows and other survivors. Because of the change to price indexing, the combined benefit that a retired couple would receive in future decades would be significantly lower than what the couple's benefit would be under current law. As a consequence, the proposal to set the survivor's benefit at 75 percent of the couple's benefit would place the survivors benefit at 75 percent of *a substantially smaller amount*. For many widows, a benefit that is 75 percent of a substantially reduced amount would result in a lower, rather than a higher, guaranteed Social Security benefit than they would receive under the current Social Security benefit structure.

Another group of survivors that would be adversely affected consists of minor children of workers who die. Their Social Security survivors benefits, as well, would be significantly reduced as a result of the change from wage indexing to price indexing.