



SOCIAL SECURITY: A Background Briefing

Social Security is the most successful program in our country's history. People look upon it as a promise —without an expiration date— that our nation has made to America's workers, their families, and to our retirees.

History. The promise of a small measure of economic security at the end of one's working days came about during a time of deep and unanticipated economic downturn of historic proportions. Even many able-bodied workers could find no employment. As a result, some guaranteed replacement of at least a portion of income for those who had spent 30 or 40 years laboring seemed imperative. If we as a nation could not maintain the dignity and independence of our elder generation of lifelong workers, the very ideals of this country were at risk. And so, Social Security was born.

The program has been periodically re-tuned as the workforce and work skills have changed. Yet, its administrative expenses remain the lowest of any government program—less than 1%. While the program insures families against loss of their breadwinner throughout life, Social Security also has proven to help millions of older Americans maintain their standard of living in retirement.

Today. Social Security is financially strong now and in no danger of "going broke" anytime in the next couple of decades. However, it is true that the program is in need of long-term measures to keep it in fiscal balance so that it will be able to pay full benefits to every generation of Americans. The changes do not have to be drastic, as examples of solvency options will show. However, the longer we wait to adjust the system, the more difficult the adjustments. That is why it is advisable to act sooner rather than later.

One of four pillars. Social Security is only part of the overall retirement security structure. A secure retirement is supported by four pillars: 1. Social Security, 2. Pension and Savings, 3. Continued Earnings, and 4. Adequate and affordable Health Insurance. In that context, the importance of Social Security today is evident as each of the other pillars faces mounting pressures.

Only half of working Americans have a pension plan available at their workplace, so millions of private sector workers have no regular payroll deduction mechanism to save for their future. Traditional defined-benefit pensions are disappearing. Many companies that do offer pensions

are converting to defined-contribution plans (such as 401(k) plans), making workers absorb more risk. The defined-contribution plans are subject to early withdrawals, poor investment decisions, and the fact that most pensioners fail to annuitize their balance upon retirement. So even if a worker has contributed to a retirement savings plan, it is likely to provide for a much less adequate retirement income level than a defined-benefit pension.

Personal savings are at an all-time low according to Federal Reserve figures, and personal debt at an all-time high. Only a little over half of U.S. families own any tax-favored retirement account,¹ and the median value is \$29,000. In contrast to previous generations who owned their homes free and clear by the time of retirement, many boomers may retire with substantial mortgages. Boomer median financial assets, excluding home equity, totaled \$51,000 according to latest available figures.² Many report that they are planning to work in retirement. However, the job market for older workers is difficult for most without recent training and current skills, and age discrimination is still prevalent in the hiring process.

Rising health care costs also put strain on the goal of economic security. As health care expenses go up at almost double digits annually, insurers are reducing offerings, raising prices and shifting costs. Employers are cutting back on employee health benefits and retiree health benefits alike. So retirees are paying larger and larger portions of their post-work income for health care. Even with Medicare eligibility, millions of older Americans are spending a third or more of their retirement income for health care.

The average American today will need to work longer before retiring in order to: educate the kids, possibly assist elderly parents, save adequately for retirement without supplemental defined benefits from a company pension to count on, and meet ever-rising out-of-pocket health care costs. Since other pillars are under so much pressure, the need to strengthen Social Security is all the more important.

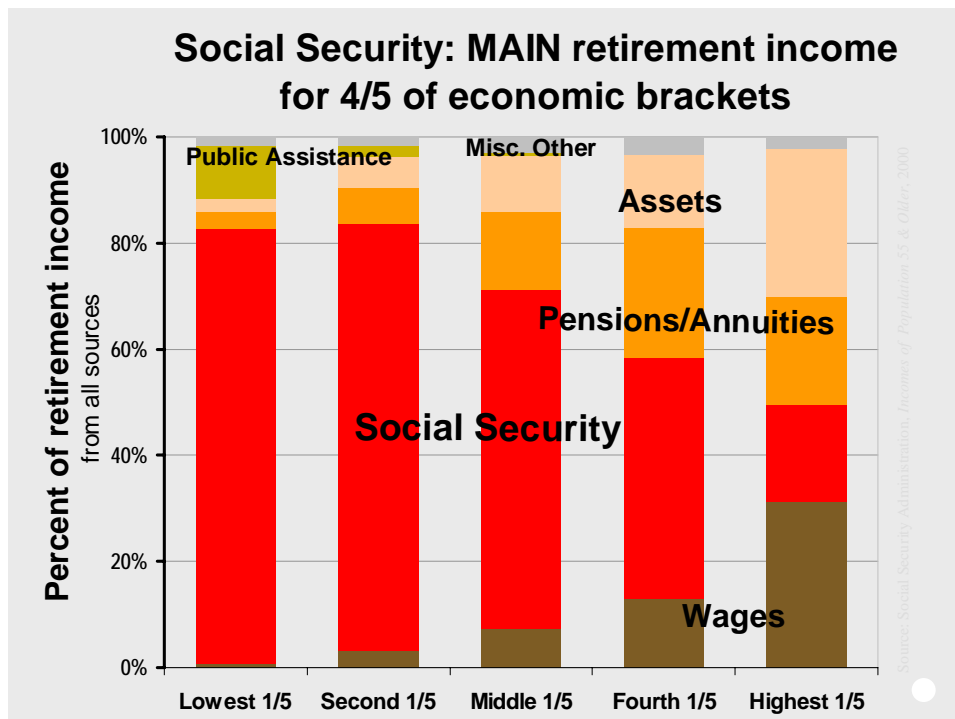
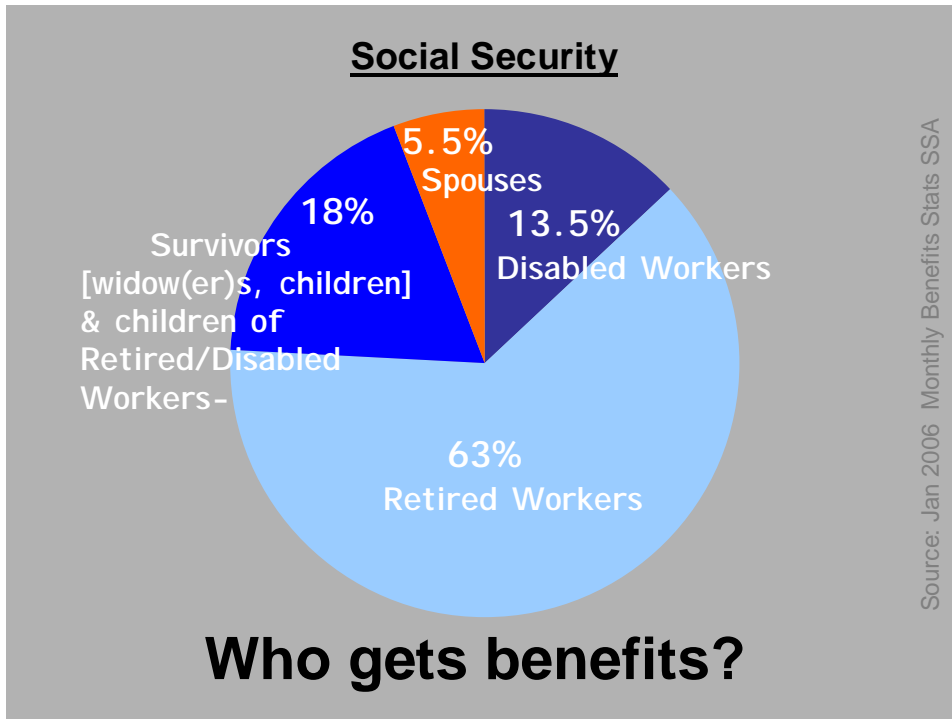
Who participates in Social Security?

About 96% of all workers contribute to Social Security. Workers pay 6.2% of their earned income into Social Security, matched equally by 6.2 % from their employer. The highest wage earners do not pay in to Social Security on the portion of their salary over the “taxable maximum.” This figure is adjusted annually by formula and is \$94,200 in the year 2006.

Those who contribute for 40 quarters will earn retirement benefits. Today, approximately 47 million receive Social Security benefits. About 6% of beneficiaries are non-working married partners (mostly wives) whose payments are based on their spouses’ earning record. Close to 19% of annual payments go to widows and widowers (and children!) of deceased workers combined. Over 13% is paid to workers disabled during their work years. The remaining (less than 63%) goes to retired workers, beginning on a date of their choosing, but after age 62.

¹ Bureau of Labor Statistics, U.S. Department of Labor, “Comparing the Retirement Savings of the Baby Boomers and Other Cohorts,” www.bls.gov, originally posted January 24, 2005

² Gist, John; Wu, Kebin; and Verma Satyendra. “The Distribution of Financial Wealth Among Boomers.” AARP Public Policy Institute Data Digest #99, July 2004



Source: Social Security Administration

For the majority of Americans—that is, for *two-thirds* of current and future retirees, Social Security is –or will be– the largest part of their income in retirement.

Adequacy

The key measure of adequacy is the “Income Replacement Rate.” Social Security is designed to favor the lower-wage worker, who might not have as much opportunity to save over a long worklife at the lower end of the wage scale. The Social Security benefit formula ensures lower-wage workers receive a higher wage replacement rate relative to their earnings so that their benefit might be more adequate.

RATE OF REPLACEMENT

- 57% of low-wage workers’ earnings replaced
- 42% of average-wage workers’ earnings replaced
- 35% of high-wage workers’ earnings replaced
- 24.8% of earnings replaced for those with consistent max-taxable-and-above wages

Any changes to Social Security’s formulas must recognize the goal of adequacy. Changes must ensure that, both by initial payment level and by cost-of-living adjustments, the adequacy of Social Security as a partial replacement for pre-retirement income is maintained.

AVERAGE SOCIAL SECURITY BENEFIT - JANUARY 2006

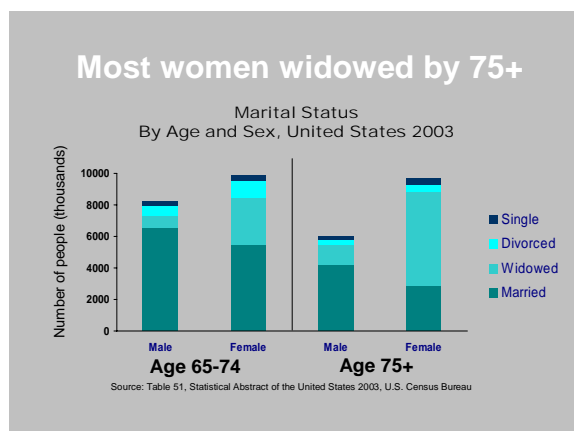
Retired worker	\$1004
Retired spouse	\$ 500
Widowed mother/father	\$ 714
Surviving child	\$ 658
Widow(er) of retired worker	\$ 950
Disabled Worker	\$ 938

Fairness

In an increasingly diverse nation where opportunities in the labor market have not been equally distributed in the past, another duty of those who would change the system is to promote fairness. African-American and Hispanic workers make up a disproportionate segment of the nation’s low and moderate wage earners. At present, the Social Security benefit formula ensures some fairness in that all lower-wage workers receive a higher percentage replacement of salary in retirement relative to their lifetime earnings.

Life-expectancy *at birth* is still significantly lower for males of these groups. A shorter life span means a person contributes to Social Security without receiving as many years of retirement benefits. So the lower life-expectancy has sometimes been used to show lower-wage earners potentially contribute more than they draw out. However, life expectancy *at 65* is only a little over a year’s difference and the gap is closing. A further balancing factor, in terms of distribution of funds, is that a higher percentage of low-wage workers draw disability benefits and a higher percentage of their families draw survivor benefits.

Women's equity issues. Women, too, are concentrated in low-wage work on average. Their median salary is \$585 a week compared to \$722 a week for men. In other words, women are paid about 81% of what men are paid, a figure which unfortunately tends to stand over a lifetime. For *one of every four* unmarried women over 75, their only source of income is their Social Security check. Since women tend to live longer, a Cost of Living Adjustment (COLA) calculated on the Consumer Price Index year after year is crucial to keep these lone former workers from falling into poverty as they age. Women (and men) who have been married to other workers get the higher of either benefits accruing (as spouses) from their partner's work record or their own work earnings, but not both.



Social Security benefits are computed on the amount of salary earned, on the number of years workers pay in, and on age at the chosen time of retirement. The median earnings of full-time workers in 2004 were \$40,798 for men and \$31,223 for women—over \$9,000 difference. Coupled with that, the median number of years of covered employment was 44 for men and 32 for women—12 years difference.³ The disparity in work-years is due to the fact that many women stay out of the workforce to raise children and/or care for other family members for several years. These numbers —lower salaries combined with fewer years of work— typically result in much smaller Social Security checks for women every month the rest of their lives.

Poor & Near Poor, 2001 (within 150% of Poverty)⁴

Age	Men	Women
60-64	16%	20%
65-74	17%	24%
75+	20%	33%

³ Source of median data: Center for Retirement Research, *Why Are So Many Older Women Poor?*, by Alicia H. Munnell, April 2004

⁴ Source: U.S. Census Bureau, Current Population Survey

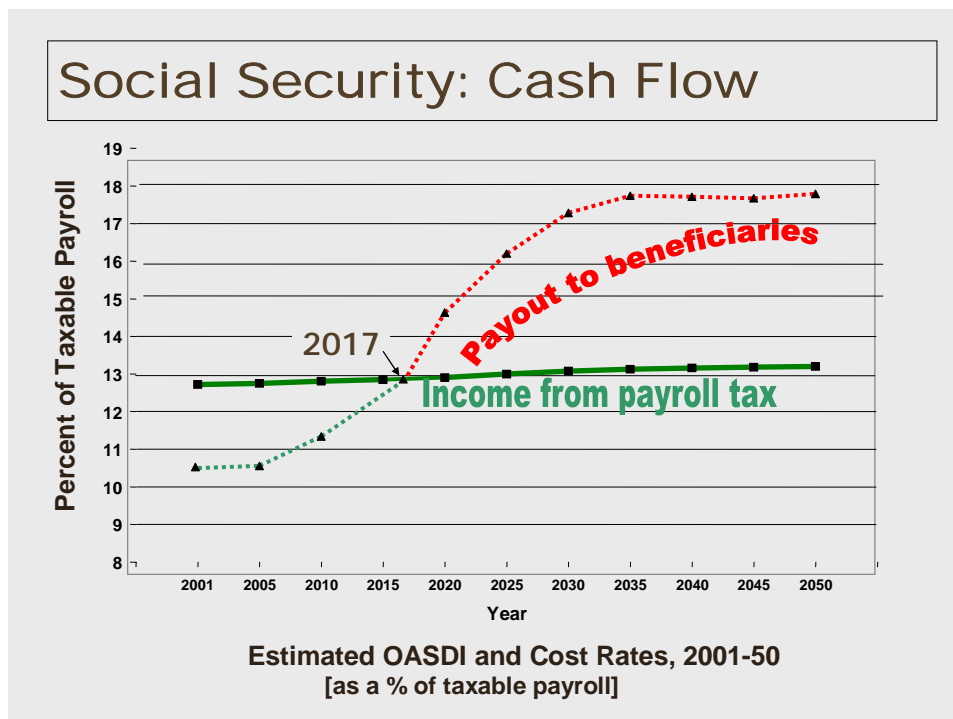
So, there are really three sets of Social Security reform issues. The first, less known and less reported, are the issues around the family structure and women in a world that now expects women both to work and to care for family—young and old. These *fairness* or equity issues arise because Social Security tracks one's link to the *paid* labor force without crediting caregiving years, which are nevertheless valuable to society. In fact *motherhood* is the single biggest risk factor for poverty in old age in the United States.⁵

Issues of adequacy and solvency define the public debate today. Social Security solvency is a widely-shared goal, but approaches differ as to how best achieve that.

Solvency

Solvency is a major focus of the current reform discussion. According to the Social Security trustees, the system is out of long-range balance by about 2.02% of payroll.⁶ The Congressional Budget Office (CBO) estimate is 1% of payroll. Either gap can be closed through the combination of a number of solvency options.

Since the Social Security system pays retirees, widows, orphans, and the disabled and their families each year out of the funds collected from current workers' payroll checks (and some of the income taxes paid on benefits), it is sometimes referred to as a pay-as-you-go system.

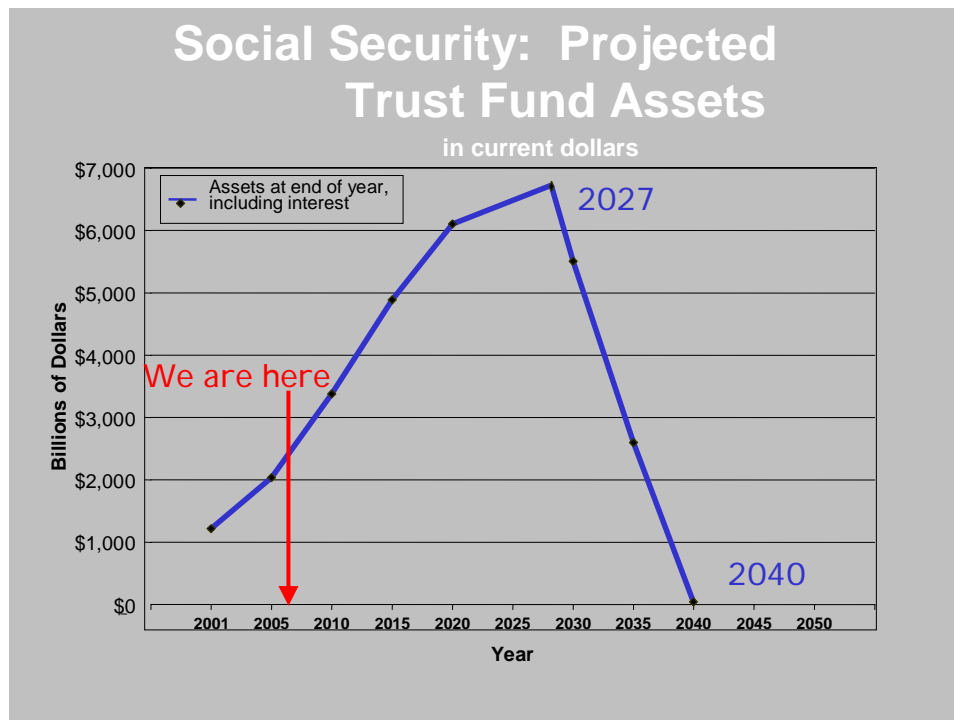


⁵ *Women and Social Security: Important Issues for Financial Security of Older Americans*, presentation by Anna M. Rappaport, F.S.A, May 21, 2004, Mercer Human Resource Consulting

⁶ *2006 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds*

Demographic changes including slower workforce growth and longer lives affect the projected annual Social Security balance sheet.

Recognizing well in advance the population bulge created when births were delayed by World War II (the phenomenon known as the baby boom), excess collections were legislated in the early '80s to create a surplus in the Social Security Trust Fund designed to meet the nation's obligations to boomers' retirement. For years, Social Security's income has exceeded its pay out, and the Trust Fund has grown, as intended.



As of early 2006 the Trust Fund reserve was \$1.86 trillion, for another \$172 billion was added in 2005. This surplus is invested in special U.S. Treasury bonds that currently generate almost \$90 billion in interest at an average rate of 6% for the Trust Fund. These bonds are backed by the “full faith and credit of the United States.” This means that the nation is fully obligated to honor them when they are redeemed.

Annual payments *into* the Trust Fund —payroll contributions and dedicated taxes— are projected by SSA to *exceed* annual benefit payments until 2017. The CBO projects 2019. By then, the rising number of boomer retirees will have caused benefit payouts to rise. At that point, some of the interest that accrues each year will have to be combined with payroll taxes and income taxes to pay retirees.

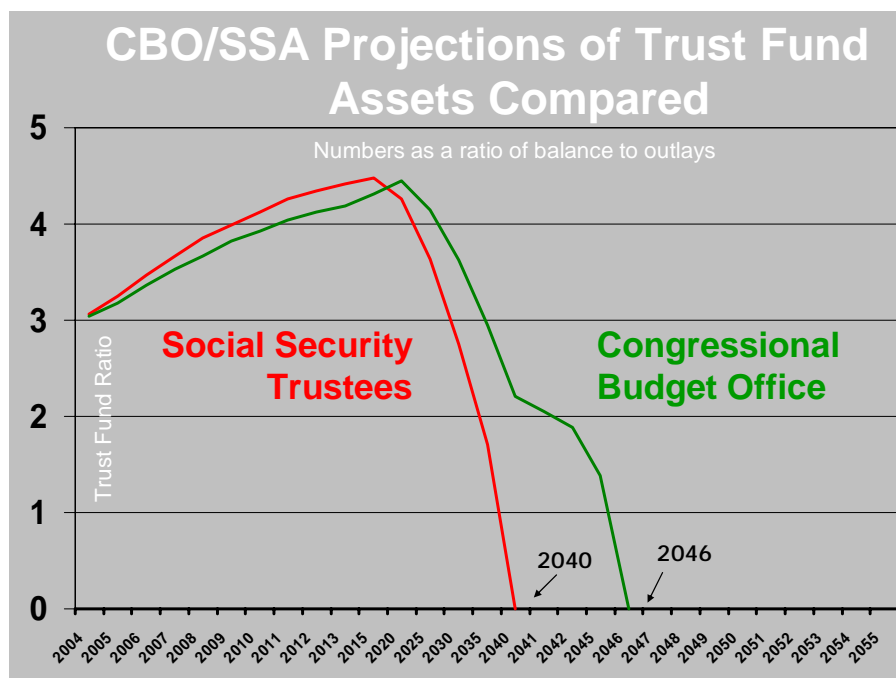
The year payouts exceed income is a significant date for Social Security. It's important not because the program is in financial trouble at that point, but because the rest of the budget may be in trouble due to unsustainable fiscal policies. After more than 30 years of borrowing *from* Social Security, the U.S. Treasury will be called upon to transfer cash resources back to the Trust Fund. Right now the rest of government is borrowing more than \$150 billion in revenue a year from Social Security, which the Congress is dedicating for various purposes at home and abroad.

In exchange for the borrowed funds, the Treasury promises future interest payments to the Trust Fund as well as return of principal. Right now that only requires the Treasury to pay the Trust fund in interest-earning bonds, not cash, whenever the interest is due. Yet, the Treasury will have to redeem those bonds later. It is estimated that beginning in 2017, Social Security will have to start calling upon the Treasury to make the interest payments in cash rather than bonds. That way, all Social Security benefits can be paid.

So 2017 (or 2019) is a problem not for Social Security but for the Congress. After those years, Congress must come up with the interest money the Treasury owes Social Security. Raising this money is a problem because the “unified budget” is already running large deficits—gross federal debt has increased between 2002 and 2006 by \$2,414 billion with no sign of the trend abating. Our current fiscal policy therefore is the cause of the concern for the future of Social Security.

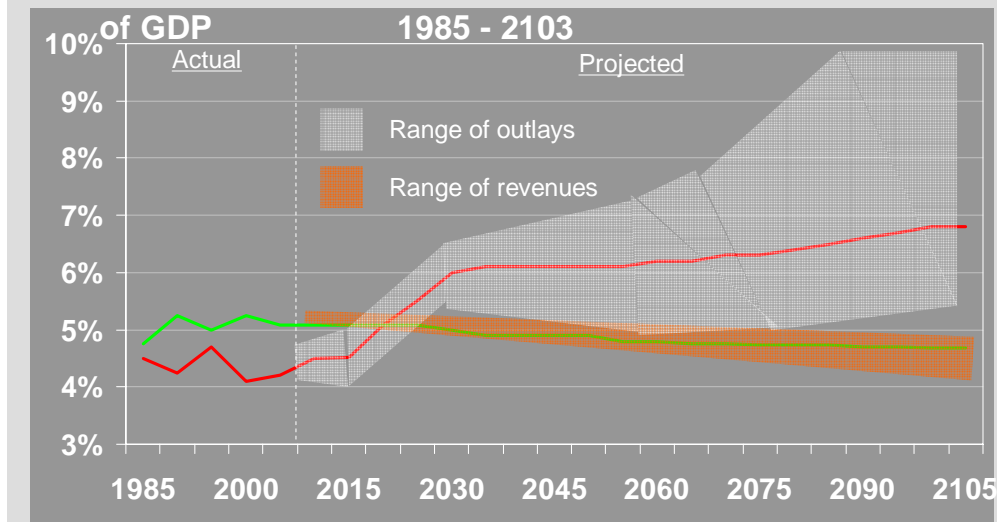
The situation changes again about 2027. Then, the annual payout will begin to exceed annual income plus interest earnings, and the bonds that the Trust Fund holds will need to start being redeemed. The Social Security actuaries conservatively project that the Trust Fund balance will be depleted by 2040. However, even after that date, Social Security will not be “bankrupt.” *Annual collections from payroll taxes would be sufficient to pay over 74% of promised benefits.*

The Congressional Budget Office (CBO) projects the Trust Fund will not be depleted until 2046, 6 years beyond the Social Security Administration projections. The difference is due to very small variations in economic assumptions, primarily interest rates. Differences illustrate the uncertainty of any attempt to project very far into the future.



The difference is significant because the CBO is using a very sophisticated econometric model. Also, congressional leaders will rely on the CBO figures, not Administration figures, just as they did in the Medicare debate. Various economic and demographic assumptions plugged into the model result in a *broad range* of projected outlays and a narrower –but still significant– *range* of program income.

CBO: Potential Range of Social Security Outlays & Revenues Under Current Law



This serves to point out that there is not just one “solution” to Social Security’s solvency. The CBO entry into the debate is also significant because the current long-term imbalance looks only half as big through the CBO lens. If the CBO projections are correct, more modest changes would be sufficient to guarantee current obligations and continuous Trust Fund solvency.

SOCIAL SECURITY SOLVENCY OPTIONS

There are many ways to adjust the Social Security program to achieve solvency. A number of the options presented here illustrate the range of possible changes that, taken in certain combinations, could be enacted to restore Social Security’s long-term solvency. Each will be presented with: 1. Current law, 2. Estimated impact that passage of the measure would have on the projected Social Security shortfall after 2040 (using SSA figures as a baseline), and 3. Brief acknowledgement of the arguments both for and against adopting the policy.

Option 1. Raise total wage base taxed by Social Security to 90% of nationwide earnings

Under current law: About 85% of total wages nationwide are now taxed. The maximum wage subject to Social Security payments in 2006 is \$94,200. (Higher salaries require no added payment into Social Security.) The proposed cap would be \$140,000 phased in over 10 years.

Impact on projected shortfall: This measure would lower Social Security’s projected shortfall by 43%.

Proponents point out that this would affect only a small number of workers (6%). Twenty years ago, Social Security received revenue from 90% of the total wage base paid in the U.S. However

the growing gap between high and average salaries, and a slightly flawed calculation formula have dropped that figure to 85% today.

Opponents maintain that the new Social Security ceiling would be a “tax increase” for that 6% of people whose wages exceed the cap and for the businesses that employed them. So employers, especially, may object to added costs for their higher-paid employees.

Option 2. Raise amount of earnings subject to full Social Security payroll tax to \$120,000 and subject earnings over \$120,000 to a 3% surtax.

Under current law: The taxable wage cap in 2006 is \$94,200 —no further tax is owed on higher salaries. The maximum taxable wage base has already been eliminated for Medicare. Option Two would raise the cap to \$120,000 over 13 years. In addition, wages over the new cap would be subject to a 3% surtax that would begin at 1% (evenly split between employers and employees) and gradually rise to 3%. The new surtax would not be linked to benefits.

Impact on projected shortfall: This option would fill about 50% of Social Security’s projected shortfall.

Proponents note that this is one of the most progressive solvency options (that is, protecting lower income workers more, and asking more of high earners). Given that earnings and longevity have increased more for high earners than low earners, asking higher earners to pay more into Social Security is fair. Unlike Option One, which impacts a small group of workers the most (those earning between \$90,000 and \$120,000), this option would ask a larger number of very high earners to cover a much greater share of the solvency burden than they do now. It would require them to pay Social Security taxes – at a lower rate of 3% – on all of their salaried earnings. This tax, when fully in effect at 3%, would be smaller than the 4.6% reduction at the top of the marginal income rate since the beginning of 2001.

Opponents believe that applying a payroll tax on all earnings, even at a reduced rate, is unfair, particularly since these workers would not receive any further credit toward increased retirement benefits as a result of increased tax payments. Placing a greater burden for solvency on high earners may erode their support for the Social Security program.

Option 3. Include state & local government new hires under Social Security beginning in 2005

Under current law: Approximately 95% of all jobs in the USA are now covered under Social Security. The largest exception is about 30% of state and local government workers.

Impact on projected shortfall: Lower by 9%

Proponents point to the seamless career coverage workers would get from job to job instead of paying into a government pension system for a number of years and into Social Security for other years, thus failing to maximize retirement benefits. The disability coverage is quite a bit better under Social Security than in most state plans, and the payments for dependents and spouse in case of death much improved over state and local government pensions. In addition, few states or municipalities offer full cost-of-living adjustments, lack of which significantly reduces the value of their pensions over time. Others point out that many state and local

government workers receive Social Security spousal benefits now as a result of marriage, and therefore it is only fair that they contribute. New federal employees, including Members of Congress, were brought under Social Security in 1983.

Opponents note that the positive impact on the Trust Fund for including the state and local workers diminishes over time as these new payees will eventually retire, and Social Security must meet that obligation. It is also politically unpopular since most state and local workers are opposed to the change, not realizing that for most, it would be a better and more secure retirement benefit, and provide superior insurance in the case of disability and dependent benefits, if needed.

Option 4. Raise the Social Security tax by ½ percentage point (¼ point each, employer/employee)

Under current law: The Social Security payroll tax equals 12.4% of wages. Half of this is paid by the employer, half by the employee on each salary up to \$94,200. Those who are self-employed pay all 12.4%.

Impact on projected shortfall: Adoption is estimated to lower Social Security's projected shortfall by 24%.

Proponents of this option point out that it is consistent with past policy: past payroll tax increases helped assure solvency. They emphasize that this option would only affect current workers, not retirees. Contribution rates would only change from 6.2% to 6.45% each.

Opponents fear it could have a negative impact on the creation of new jobs, and that it might reduce workers' personal savings outside of Social Security.

Option 5. Gradually raise the age at which one can receive full benefits to 70 by 2083

Under current law: The age to collect full Social Security benefits is greater than 65 but less than 66 if a person is born between 1938 and 1943. The age is 66 if born between 1944 and 1954. The age is greater than 66 but less than 67 if born between 1955 and 1959. And for a person born in 1960 or later, the age for full benefits is 67. A person may collect *reduced* benefits anytime after age 62. Their reduction is prorated for the exact month their payment starts. Certain widow/widowers may collect reduced benefits at age 60.

Impact on projected shortfall: Lower by 38%

Proponents refer to our longer projected life span, which at age 65 already has increased from 78 to 83. So increasing the number of working years in a now-longer lifetime makes sense, they say. In addition, longer work lives on the part of those already in the workforce would aid expected labor shortages.

Opponents calculate that this measure results in overall reduced benefits for *all* retirees. Extending work life has an unfair impact on those who do physical labor whose health and strength cannot endure. Coupled with this is the fact that these physical laborers are, in the main, lower-wage workers. For white collar workers, jobs for the same skill set may not exist that far

into the future and career-changing later in life can be problematic, particularly for those who are *forced* into it. For every year the normal retirement age is increased, benefits are cut 7% for those retiring at the same age as before the change.

Option 6. Increase the number of work years calculated in benefit formulas from 35 to 38

Under current law: Social Security retirement benefits are based on a person's highest 35 contributing years. For each year less than 35, a zero is entered into the calculation.

Impact on projected shortfall: Lower by 16%

Those who favor this policy option feel that it is logical: Since the Normal Retirement Age (NRA) is rising to 67, so the number of work years rises. It may encourage people to stay in the workforce longer. It is better than further increasing the Normal Retirement Age for all.

Those against show that such a measure equals a 3% reduction in benefits for new retirees. And it has the most impact on those with traditionally smaller wages and shorter work lives: women and low-wage workers.

Option 7. Index the starting benefit level for improvements in “average longevity” at 65

Under current law: With consistently growing life spans, increasing years of benefits are expected to be paid to retirees. To balance this, initial monthly payments could be slightly lower beginning in 2018, calculated on the basis of changes in longevity at age 65.

Impact on projected shortfall: Lower by 25%

Proponents point out that, statistically, the actuarial total lifetime benefits would be kept equal. People will be given ample time to adjust to lower benefits expected in the future over today's retirees. This policy would act as an “automatic stabilizer” to protect the system from changes in average life spans.

Opponents show this would lower monthly benefits. Eventually, this measure lowers wage replacement rates that are so crucial to Social Security's adequacy.

Option 8. Reduce benefits for new retirees by 5%

Under current law: Benefits are scheduled to rise with real wages. This maintains a constant ratio to pre-retirement dollars.

Impact on projected shortfall: Lower by 26%

Proponents show that this measure would preserve the wage-replacement “progressivity” of the benefit formula. Since the measure would not begin for 10 years and then would reduce initial

benefits only 1% a year for 5 years, there would be ample time for the prospective retirement population to adjust plans to compensate for lower lifetime benefits.

Opponents point out that this measure hits low-wage earners with the least *non*-Social Security income the most. (Their total retirement income shrinks most.) It hurts the adequacy of benefits without regard to other income.

Option 9. Diversify 15% of Trust Fund investments into a total market index fund

Under current law: Trust Fund may now be invested only in federal government-backed securities, which earn an average rate of return of 6%.

Impact on projected shortfall: Lower by 15%

Proponents suggest that the stock market could give higher returns and that, if a portion of the Trust Fund *as a whole* were invested, the risk would be spread across the whole population and all generations. Administrative costs of this measure would be far less than for millions of personal accounts. Funds would be invested in a broad index fund (e.g. the Wilshire 5000), which invest in the entire market at very low expense.

Opponents are concerned that the U.S. Treasury, which now borrows heavily from the Social Security Trust Fund, would have to borrow more from other sources, especially foreign sources, increasing our poor economic position as a debtor nation.

Option 10. Lower benefits for higher wage workers

Under Current Law: Benefits are designed to return a higher percent of pre-retirement wages to lower-wage retirees than for those with higher lifetime wages.

Impact on projected shortfall: Lower by 11%

Proponents argue that adjusting the formula further for those with higher earnings would save money without affecting lower wage workers. Higher wage workers have more opportunities to invest and save for their retirements. Further, the wages of higher paid workers have been increasing faster than those with lower paid jobs.

Opponents point out that this change lowers the “rate of return” for higher paid workers. They see a risk that many higher-income wage earners might no longer perceive Social Security to be a “good deal” for them, weakening support for the program overall among this influential community.

Criteria to Judge Options

The 10 options presented are not a comprehensive list but serve to give an idea of the range of the measures that might be adopted. Key questions in evaluating any package chosen from the options presented: Are future benefits adequate? Are costs and benefits fairly spread? Who bears what risk? Are benefits still “progressive”—that is, do benefits assist most those who have least? What is effect on public support, confidence, and understanding? Can people adjust easily to the change? How will the package or individual option affect rest of the U.S. Budget?

PRIVATE ACCOUNT PROPOSALS

Although no specific, detailed solvency plan has been put forth by the Administration, most analysts assume President Bush is basing Administration proposals on “Plan 2” from the Social Security Commission’s 2001 report. Key changes would include setting up a mechanism to allow workers under age 55 to transfer 4% of payroll taxes to new individual private accounts.

The plan combines very aggressive cuts in guaranteed benefits with the creation of individual accounts designed to offset the impact of those cuts. One-third of payroll taxes (4% of 12.4%) would be diverted each year from the task of paying current retirees to funding investment accounts. Therefore, the Social Security Trust Fund’s status would be made much worse. In fact the shortfall would be 196% higher—that is, the shortfall is *quadrupled*, absent other changes.

Funded by Borrowing

Younger workers today would have to pay twice to finance this new plan. First, current benefits must continue to be paid even though there would be less revenue due to the diversion of payroll taxes into private accounts. So borrowing must take place to meet these obligations, requiring additional interest payments and potentially higher interest rates. Second then, the added debt must be paid off.

To compensate for the loss of Social Security revenue into private accounts, the federal government would have to borrow significant sums for the *next 50 years* in order to pay promised benefits. Proponents of this measure have not suggested another means of paying the estimated cost: \$754 billion in the first 10 years, and \$3.5 *trillion* in the following decade.

The massive borrowing by the federal government would permit individuals to invest in the stock market in the hope that the individual’s investment returns will be greater than the interest cost and administrative expenses incurred. This is a form of *arbitrage*, borrowing money to invest in the hope that investment returns will exceed interest costs.

Private Accounts

The Administration has proposed a phased-in approach to establishing private accounts. The phase-in would reduce the amount of borrowing needed for the first 10 years. Beginning in 2011, workers then 54 or younger could elect to divert 4% of their Social Security contributions into one or more of five mutual funds. That year, \$1,000 would be the maximum contribution permitted with the annual limit increasing by \$100 each year.

- Balances in worker’s accounts could not be withdrawn, or borrowed against, before retirement.
- At retirement, each worker would be required to purchase (with account earnings) an annuity sufficient to bring the total annual benefit up to the poverty level.
- Any accrued balance larger than the cost of the annuity could be used for other purposes, including willed to heirs.
- The principle contributed to the private account over the years, and inflation plus a 3.3% imputed rate of return, would at retirement be *deducted from the guaranteed Social Security benefit*. This policy is referred to as a “clawback” to help fund solvency.

Proponents of this option believe that private accounts will earn higher returns for most individuals and promote an “ownership society.”

Opponents point out that future guaranteed benefits would have to be cut deeply to finance these accounts, and that private accounts would shift risk onto the individual beneficiary, a risk not associated with Social Security now. A transition period would require heavy borrowing and additional interest obligations for taxpayers. Since small individual accounts would be expensive to administer, fees would reduce earning potential for the individual.

Solvency - Price Indexing - The Commission Plan 2 would achieve Social Security solvency solely by changing the way benefits are calculated. Workers’ Social Security benefits would gradually become smaller over time by “price-indexing” initial benefit levels. Today, beginning benefit levels are calculated by indexing workers’ wage histories to overall growth in wage levels. Retirees benefit from rising productivity during their worklife. Price-indexing would freeze the real value of earnings. This would result in about a 1.1% decrease in initial benefit level *per year* compounded for every year the policy is in effect. This could, in combination with the clawback just discussed, achieve solvency in the long run; however, it would do so *entirely by lowering guaranteed benefits* for future retirees.

Adequacy - Replacement Rates - Changing the benefit formula to price-indexing could eventually eliminate the projected Trust Fund deficit, but at the price of *drastically lower income replacement rates for future generations*. These charts show the comparison:

Price Indexing Beneficiary Impact:
Income Replacement Rates

Year of Birth	Current Law	Plan #2 Combined
1940	42.9%	42.8%
1950	43.0	39.9
1960	41.0	34.8
1970	40.5	30.9
1980	39.8	27.4
1990	39.5	24.6
2000	39.6	21.7


Beneficiary Impact: In dollars

Year of birth	Current Law	Plan #2 combined
1940	\$14,900	\$14,900
1950	\$15,200	\$14,100
1960	\$15,500	\$13,100
1970	\$17,700	\$13,600
1980	\$20,500	\$14,300
1990	\$23,300	\$14,500
2000	\$26,400	\$14,600

The impact on replacement rates for average wage earners (comparing work income to post-work income) would be to *lower* rates from 42% to 20% over 40 years—even when combined with the added income from the workers’ private accounts.

Fairness - Two of the Administration’s possible proposals that speak to the issue of fairness are: One, to add a new “minimum benefit.” This would keep benefits for lifetime workers from falling below the poverty line. And two, a proposal that widows (and widowers) draw 75% of the previous spousal benefit rather than 50% as they do now. This improvement helps a most vulnerable group: the very oldest women, whose benefits today are inadequate.

AARP’S POLICY RECOMMENDATIONS



Policy Highlights

AARP Supports

- ✓ Increasing wages subject to Social Security tax
- ✓ Diversifying investment of a portion of Trust Fund assets to increase return
- ✓ Universal coverage – adding newly hired state/local
- ✓ Individual retirement accts in addition to Soc Sec

AARP Opposes

- ✗ Creating “carve-out” private accounts diverting payroll contributions away from Social Security
- ✗ “Price-indexing” benefits
- ✗ Reducing Cost of Living Adjustments
- ✗ Increasing retirement age
- ✗ Means testing

You can also visit the AARP web site at www.aarp.org/socialsecurity for more information.

AARP is opposed to private accounts that divert money from Social Security payroll obligations. Private accounts are expensive, risky, and unnecessary. Not only would they have high administrative expenses, *extensive national borrowing* must take place to fulfill promises to current beneficiaries and those soon-to- retire. Increasing our national deficit is not prudent fiscal policy at a time when deficit figures are already at record numbers.

Social Security needs to be strengthened now for our children and grandchildren, but the solution shouldn’t be worse than the problem. Private accounts that drain money out of Social Security will cut guaranteed benefits while passing a large bill to future generations. By making sensible changes now, we can honor our obligations to all generations. Our nation needs a full national discussion of *all* the ideas on the table. Now that Social Security has moved higher on the political agenda, we must all work together to keep it adequate, fair, and financially strong. ***