

## Fixing the Part That's Not Broken

**H**OW DO YOU SOLVE SOCIAL SECURITY'S FINANCIAL PROBLEMS? This is hardly a new question, although its prominence has increased with the Bush administration's focus on the issue. The very question implies that Social Security is broken and needs to be fixed. Is this true? Is the system broken? If so, how should it be fixed to everyone's satisfaction?

The Academy has, in its way, attempted to provide answers, specifically through the efforts of the Social Insurance Committee and the new Federal Agenda Task Force. In recent months, we've received a number of calls, letters, and e-mails from members in various practice areas asking about the Academy's response to the increased attention on Social Security.

Over the past few years, the Social Insurance Committee has created a substantial body of work, mostly in the form of issue briefs. The briefs cover most of the reform measures that have been or are currently being considered, including the individual account proposals. The committee has published briefs that educate about specific design issues, raise questions of social adequacy versus individual equity, and examine the pros and cons of a voluntary or mandatory program. These briefs are shared with policy-makers as a means of helping them understand the critical issues without endorsing one reform proposal over another.

Last year, in preparation for the 2004 presidential election, the committee also created a voter guide containing questions that should be answered by any reform proposal. The guide effectively summarized a number of the committee's issue briefs in a manner that encouraged use by media outlets and the public as well as policy-makers. This guide is currently under revision to more adequately reflect the current environment. (By the time you read this, the guide should be available on the Academy's website.)

In addition to the guide, the committee held a series of Capitol Hill briefings last year. The briefings were designed to provide policy-makers and their staffs with information on reform options, the pros and cons of each, and the impact they would have on the solvency of the Social Security program. We will also be holding one or more Hill briefings on Social Security this year, as well.

But wait that's not all. The newly created Federal Agenda Task Force, composed of actuaries from all

practice areas, is chaired by Ron Gebhardtshauer, the Academy's senior pension fellow, with Senior Health Fellow Cori Uccello as co-chair. The afternoon before the president's State of the Union address, the task force

sponsored a press conference to: 1) encourage action on Social Security's solvency sooner rather than later; 2) discuss the assumptions behind the \$10.4 trillion deficit based on infinite projections; and 3) provide background education on the impact of an individual accounts program. The conference allowed the Academy to engage in public dialogue on the issue of Social Security, which many members have been encouraging. Not only did the conference result in an opportunity to expand the Academy's media contacts; the number of press calls we've received since the conference has nearly doubled over what we were receiving before.

Though both the committee and task force are actively engaged in the dialogue on Social Security, the Academy hasn't endorsed any single proposal for reforming Social Security. This is, of course, consistent with the Academy's non-partisan mission. With that said, I would like to step out on my own and talk about what I consider acceptable solutions to the problem and the rationale behind my preferences.

### Social Security Game

Several years ago, the Academy created a Social Security game (<http://www.actuary.org/socsec.htm>), which has received increased attention in recent months. Most notably, the *Baltimore Sun* ran a full-page article on the front page of the Sunday business section on the options provided within the game. While contemplating the subject of this article, I decided to sit down during lunch one day and play the game.

This is how I would solve Social Security's solvency issues (as a side note, the numbers/percentages used below will have changed slightly by the time you read this article):

The first option I would choose is to accelerate the increase in normal retirement age to 67 and index it thereafter. Life expectancy has increased substantially since 1983 when the initial increase in retirement age was legislated. With increased life expectancy, it makes sense that I would need to (and frankly, want to) work longer than my parents to have enough money to last

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through my retirement years. According to the game, this solves 33 percent of the problem. Logically, an increase in retirement age within Social Security would be consistent with an increased retirement age for other retirement programs such as private-sector defined benefit plans and 401(k)s. As such, even though the Social Security age would be higher, I should still have another retirement plan to use if I decided to retire earlier.

Would this be acceptable to everyone? Absolutely not. Those in physically demanding jobs and those without another form of retirement income who want to retire early would certainly not support such a choice.

The second option I would choose is to raise the payroll tax on workers and employers by 1/2 percentage point each. While this reform option solves approximately 51 percent of the problem, increasing taxes may not be popular or easy to sell. In order to ensure Social Security's solvency, however, it seems a small price to pay for a guaranteed benefit at retirement—especially in an era of decreasing defined benefit plans and increasing defined contribution plans.

The third option I would choose is to increase the maximum earnings subject to Social Security tax by about one-fourth, to \$112,500. This completes my process. By solving 26 percent of the problem, this option, in combination with the others, has allowed me to solve Social Security's solvency issues and ensure full payment of benefits upon my retirement. However, increasing the earnings subject to Social Security tax is also not a popular option among those in the higher income levels because of the inequity in benefits received.

If you play the game, you'll note that there is not a reform option available that would be accepted universally. Other options included in the game are:

- reduction of the cost-of-living adjustment by 1/2 percentage point;
- reduction of benefits by 5 percent for future retirees, reduction of benefits for those whose retirement income exceeds \$50,000/year, taxation of benefits like pension benefits, inclusion of new state and local government workers, and investments in the private sector. It will re-

In recent months, we received a number of requests for information from actuaries who would like to engage their own communities in discussions on Social Security. The Academy has created a speaker's kit for use by these people. We encourage you to visit the Academy's website (<http://www.actuary.org/socsec/speakerskit.htm>), and use the resources we have provided, including PowerPoint presentations on reform proposals and Social Security solvency issues, as well as a sample speech.

quire a series of decisions by policy-makers, which is why it is essential for those workers (especially the 20-30-year-olds) to consider carefully the reforms available and actively engage their representatives and senators in an effort to ensure the best possible outcome.

### Individual Accounts

As you'll notice (above), I opted not to consider individual accounts as part of Social Security reform. At this point, I would like to remind everyone that the following thoughts are my own and not those of the Academy, its members, committees, task forces, work groups, meeting organizers, media contacts ... you get the idea.

I don't like the concept of individual accounts. As a 20-something, I'm the exact demographic the current administration is trying to sell on its proposal for these accounts, but I'm not buying. In my position at the Academy, I work with pension and Social Security issues daily. I'm well educated with a reasonable understanding of markets and the necessary considerations for making investments. Like many people, I have a 401(k) plan and actively take on the challenge of trying to get a reasonable rate of return on my somewhat aggressive investments so that I can look forward to a stress-free retirement—in many, many, many years.

Frankly, my 401(k) plan provides enough risk for me. Until now, even with the decrease in defined benefit plans and the increase in defined contribution plans, there was still a balance. While more likely to have a 401(k) than a DB plan, employees could still count on the guarantee of a Social Security benefit with its inherent DB structure. Individual accounts

alone, in proposals that are currently being discussed, do nothing to help restore Social Security's deficits; it's the benefit reductions that provide solvency for the Social Security program. With individual accounts, the benefit reduction employees receive from Social Security would be offset by the amount earned through their own accounts. An employee would have to invest well, receiving better than 3 percent real rate of return (about 6 percent nominal), in order to do better than she would under the current system.

Unfortunately, I firmly believe that there is substantial disparity between the average person's belief in his or her ability to receive exceptional returns and the actual ability itself. This is especially true for those employees who most need the Social Security benefits—low-income workers. While I, at times, doubt my own ability to adequately invest, I can at least afford to pay for investment advice if necessary. This option may not be available to many workers.

On Aug. 14, 1935, Franklin D. Roosevelt, in signing the legislation establishing Social Security, stated, "We can never insure 100 percent of the population against 100 percent of the hazards and vicissitudes of life. But we have tried to frame a law which will give some measure of protection to the average citizen and to his family against the loss of a job and against poverty-ridden old age. This law, too, represents a cornerstone in a structure, which is being built but is by no means complete.... It is... a law that will take care of human needs and at the same time provide for the United States an economic structure of vastly greater soundness."

Arguably, Social Security was created to ensure that most people do not end up impoverished as they grow older. Allowing the system to retain its defined benefit structure is essential to upholding its original, idealistic purpose. If nothing is altered within the current system, Social Security will still be able to pay approximately 73 percent of benefits in 2042. Reform is needed, but I just don't believe the answer lies in individual accounts. Fortunately, most proposals make participation in the private accounts voluntary.