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# Prospects for Social Security and Retirement Reform

**by Dallas L. Salisbury**

▶This article discusses the implications and effects, to date, of the 2000 election outcome on both Social Security and retirement policy. *Although the post-ERISA trend of less paternalism and greater individual choice will likely continue, we cannot expect significant retirement policy or Social Security reform until one political party is clearly in control of the government or until Social Security faces an immediate financial shortfall.*◀

The election of George W. Bush as president, as the GOP maintained control of both the U.S. Senate and the House of Representatives, presented the nation with a 50-year first: all three branches of government in control of the Republican Party. While the margins in Congress were slim, the situation provided the new president with the ability to move his first priority, a major tax bill, through Congress and into law. The decision by Senator James Jeffords (I-Vt.) to leave the Republican Party shifted control of the Senate to the Democrats just after this victory for the president, but it was a victory nevertheless. That victory included a substantial number of pension changes that had been contained in legislative proposals for years, but had not made it through the process. Ironically, the president did not want these bipartisan changes included in the tax bill but accepted them as part of the larger tax legislation.

Other retirement and nonretirement actions already taken by the Bush administration also show clear differences from what directions might have been if Vice President Gore had been elected. First, President Bush campaigned as an advocate of fundamental Social Security reform. His opponent used the refrain of maintaining the current Social Security program and adding "Social Security Plus Accounts" on top. President Bush has now appointed a Presidential Commission and has made it clear that he intends for it to consider the fundamental move from pure social insurance to a program that integrates individual accounts.

Second, President Bush campaigned during the time when Congress and then-President Clinton failed to reach a budget accord because of the ergonomics regulations that the Clinton administration was developing. President Clinton had the regulations issued while Congress was in recess. Congress returned and passed a budget, but it did not repeal the regulations. After President Bush was elected, the new Congress acted, with his blessing, to repeal them. The U.S. Department of Labor is now working on an alternative proposal. Repeal would not have happened if the Democrats had controlled the Senate.

In short, the election outcome made a difference to the futures of Social Security and retire-

ment policy. A major tax bill was enacted with retirement provisions, and a Social Security Commission that agreed in advance to a package that includes individual accounts will release recommendations in late 2001 for consideration by the nation and Congress.

## PROSPECTS FOR SOCIAL SECURITY REFORM

Social Security is the most significant retirement, survivors and disability income program in the nation. It has done more than any other program to lower rates of poverty, and it is the primary source of income for most retirees. The co-chairs of the Presidential Commission have highlighted these facts, as well as the need for comprehensive reforms to ensure the Social Security program's long-term solvency. Whatever is done to Social Security will have implications for the pension system and for savings.

Social Security was the "third rail" of politics from the 1930s until the 1998 elections. During the 1996 election, a handful of congressional candidates advocated "partial privatization" of Social Security and got reelected. During the White House/Congressional National Summit on Retirement Savings in June 1998, nearly every elected speaker talked about Social Security, with all the Republicans, and some of the Democrats, mentioning "individual accounts." President Clinton then proposed the creation of a system of retirement savings accounts that would be financed through tax credits. He proposed those accounts as an add-on to the Social Security program, rather than as part of the Social Security program itself (among those advocating the latter were Democratic Senators Moynihan, Kerry and Beaux). Then-Vice President Gore continued this theme in his 2000 campaign for president with his proposal for "Social Security Plus" accounts. The result was that both parties had adopted the notion that there should be individual accounts to supplement the social insurance program. While the policy wonks understood that there was a substantial difference between the approaches, most of the general public did not. The third rail was turned off.

The challenge of long-term solvency, however, persists. And the existence of a large trust fund of special government securities is not an automatic extender of solvency, as the government must redeem the securities. The Clinton administration's 2000 budget summed up the problem perfectly:

> Balances are available to finance future benefit payments and other trust fund expenditures—but only in a bookkeeping sense. . . . They do not consist of real economic assets that can be drawn down in the future to fund benefits. Instead, they are claims on the Treasury that, when redeemed, will have to be financed by raising taxes, borrowing from the public, or reducing benefits or other expenditures. The existence of large trust fund balances, therefore, does not, by itself, have any impact on the Government's ability to pay benefits.[1]

In accepting seats on President Bush's Social Security Commission, appointees agreed to propose reforms that meet the following six principles set forth by President Bush:

- Modernization must not change Social Security benefits for retirees or near-retirees.
- The entire Social Security surplus must be dedicated only to Social Security.
- Social Security payroll taxes must not be increased.
- The government must not invest Social Security funds in the stock market.
- Modernization must preserve Social Security's disability and survivors insurance programs.
- Modernization must include individually controlled, voluntary personal retirement accounts, which will augment Social Security.[2]

Legislation introduced in the past by Senator Gregg, Congressman Kolbe, Congressman Shaw and others will likely be revised to match the Commission's recommendations and then reintroduced.

To follow the six principles set forth by President Bush, the Commission will have to address many issues in order to create a reform package that provides even the prospect of long-term Social Security solvency. During the period from 1997 to 1999, Social Security reform was the subject of many analyses, commissions and studies.[3] Each served to underline the complexity of the issues involved and the scope of interests that would be affected by any reform. In

addition, many surveys were undertaken that underlined the complexity of public feeling about Social Security and reform options. The survey results suggest that reform will be long and difficult once the parties agree on what should be done, and almost impossible without such agreement.[4] The president can be expected to take the Social Security Commission's recommendations to the public in 2002, urging the public to tell their members of Congress to vote for reform. It is highly unlikely that legislation will be voted upon prior to the 2002 elections. If it is voted on, it will fail, but a clear election issue will have been set. Both parties will believe that they have the upper hand on the issue. Having campaigned on Social Security reform, the prospects of passing a package that includes voluntary individual accounts is quite high if the outcome of the 2002 election finds the Republicans in control of both the House of Representatives and the Senate. Should the Democrats retain the Senate, and particularly if they regain control of the House, the prospects for action prior to the 2004 election move toward zero. The bottom line is that reform will not happen anytime soon.

## RETIREMENT POLICY REFORM

Past Republican presidents proposed and signed into law income limits on individual retirement accounts (IRAs), reductions in pension funding and contribution limits, and reductions in the amounts that individuals themselves can contribute to plans. President Reagan had proposed the repeal of Section 401(k) as part of the "Treasury I" tax reform proposal that eventually led to the Tax Reform Act of 1986. The central purpose of those reforms—lower income tax rates paid for by fewer exceptions and incentives—continue to represent a central tenet of the Republican Party.

More recent Republican proposals have called for either a consumption tax or flat tax system to replace today's income tax system. In either case, many of the current tax incentives for pension plans would be eliminated. In the case of a consumption tax, under which all savings would be tax-exempt until spent, there would be no apparent need for any of the pension system as we know it. Although this would not be entirely true for defined benefit plans when focused on the payment of annuities, it would be entirely true for any plans paying lump-sum distributions. The insistence of President Bush on rate reductions has required him to oppose retirement incentives and reforms. Otherwise, there was bipartisan support for these proposals, and even strong flat tax advocates like Congressman Dick Armey (R-Tex.) urged inclusion of the pension incentives. Congress included them, and the president signed the legislation.

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The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) took many retirement issues off the table after many years, including:

- IRA limit increases
- Defined benefit, defined contribution, and total contribution and benefit limit increases

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- Catch-up contributions for IRAs and defined contribution plans
- Top-heavy rule modification
- Nonrefundable credits for elective deferrals and IRA contributions
- Credit for pension plan start-up costs for small employers
- Faster vesting for some employer matching contributions
- Increased rollover flexibility of distributions
- More detailed notice requirements for conversions to cash balance plans
- Education IRAs and savings provisions
- Allowing some retirement planning services as nontaxable benefits
- Providing for mandatory cashouts of more than $1,000 to be rolled over to an IRA if the employee provides no direction otherwise
- Making it possible for plans to facilitate IRA contributions and qualified plan Roth IRA contributions.

Some retirement provisions were left out of EGTRRA either because they could not be classified as revenue related or because there was not enough money to “pay” for them. These include:

- Tax-free IRA withdrawals for charitable purposes
- Accelerating the adjusted gross income (AGI) schedule, which determines whether amounts contributed to IRAs are deductible
- Increasing the Roth IRA eligibility AGI limit to $95,000 for single persons and $190,000 for married persons filing joint income tax returns
- Increasing the Roth conversion AGI limits to $100,000 for single persons and $200,000 for married persons filing joint income tax returns
- Amending the definition of key employees to disregard stock held by spouses or children in figuring who is a 5% owner of the business
- Providing a nonrefundable 50% tax credit in lieu of a tax deduction for half of employer contributions to nonhighly compensated employees—not to exceed 3% of nonhighly compensated workers’ compensation
- Providing a three-year credit for new small employer plans that do not exceed 50 employees. In turn, employers would be required to provide nonelective contributions of at least 1% with a 3/5 year vesting schedule. Such plans would have been unable to cross-test or use permitted disparity.
- Reducing to 10% the 50% penalty tax on failure to make minimum distributions[5]
- Requiring DC plans to furnish a benefit statement to each participant at least once a year and to beneficiaries upon request
- Requiring DB plans to furnish a benefit statement to each participant at least every three years unless participants are provided with an annual notice of the statement’s availability. (Existing rules requiring benefit statements on request would have remained.)
- Allowing 5500EZs for plans with less than 25 employees.[6] Also, exempting “one-participant” plans holding less than $250,000 in assets from having to file an annual report
- Providing new language instructing the secretary of treasury to update and improve the Employee Plans Compliance Resolution System
- Requiring the secretary of treasury to issue new regulations relating to 401(a)(4) nondiscrimination and 410(b) coverage tests
- Providing that notice under 402(f), 411(a) and 417 can be made up to 180 days (currently 90 days) prior to distributions

- No longer requiring annual report summaries to be provided to participants if the summaries are made available for examination and provided to participants upon request
- Amending the Employee Retirement Income Security Act of 1974 (ERISA) to allow DC plan sponsors and noncovered DB plans to elect to transfer missing participants' benefits to the Pension Benefit Guaranty Corporation (PBGC) upon plan termination
- Reducing PBGC premiums for new small plans (plans with 100 or fewer employees) to $5 per participant for five years.[7]
- Phasing in PBGC variable rate premiums new small plans (with 25 or fewer employees) over five years, with a permanent $5 maximum
- Authorizing the PBGC to pay interest on premium overpayments
- Relaxing restrictions on substantial owner benefits in terminated plans by increasing ownership criteria from 10-50%
- Making civil penalties under ERISA 502(l) discretionary. "Allocable recovery amounts" subject to the penalty would have been amended to exclude any recovery paid within 30 days of a notice of violation from the Department of Labor. (Would have applied to any fiduciary breach after enactment.)
- Relaxing regulations under ERISA Section 203 benefit suspension so that individual participants working past retirement age would not have to be notified if the information is included in the summary plan description
- Having Treasury report, within five years of the passage of legislation, on any expansion of pension coverage for low- and middle-income workers and preretirement use of benefits.

As with all legislation, EGTRRA included many provisions that required the Treasury to issue fast guidance because of early effective dates. In addition, discussion of technical corrections legislation began before the president even had signed the measure into law. The incubation period for retirement reform legislation is always long, so the prospects for additional reforms prior to the 2002 election must be viewed as very low. Issues such as investment advice legislation might gain life if Republicans regain control of the Senate, but significant changes in the ERISA fiduciary provisions are unlikely as long as split government continues.

Lack of ability to enact legislation does not mean that proposals will not be set forward, however. Past Republican proposals have included repealing the excise tax on asset reversions. It was the Republican Party that blocked enactment of proposals to restrict the conversion of traditional defined benefit plans into individual account designs. Position papers from the Republican congressional leadership, and from those being appointed within the Bush administration, suggest that such traditions are likely to continue.[8]

For plan sponsors and plan participants, Republican leadership likely will lead to administrative policies that honor the role of the voluntary plan sponsor as the "legitimate" decision maker in issues of plan establishment, design or termination, or the bargaining parties, while enforcing the laws that seek to ensure that promised benefits are delivered. Delivering promised benefits is likely to be interpreted as not precluding the plan sponsor from terminating or freezing a plan. Individual accounts, individual decision making, lump-sum distributions, and the ability to use account balances for many life contingencies over one's working and retired lifetime can also be expected to be the rule, not the exception. The fact that the sponsoring employers and unions are seen as free to make decisions is and will continue to be viewed as less desirable than full individual discretion. IRAs and individual account plans are and will continue to be the favored way to deliver retirement savings and income.

Robert Reich, the Clinton administration's secretary of labor, is one of the few Democrats to have ever consistently advocated the standard Republican principles of greater individual discretion and control. For decades, senior Bush administration appointees such as Secretary of the Treasury O'Neill, Economic Advisor Lindsay and Assistant Secretary for Tax Policy Weinberger have advocated increased use of individually based programs and increased individual flexibility. For congressional Republi-

cans, such views are the rule, not the exception, as they are in the Democratic Party. They are the grist of most writings and policy proposals that emerge from such think tanks as the Heritage Foundation, the CATO Institute, the Hoover Institute at Stanford University, the National Center for Policy Analysis and, somewhat less frequently, from the National Bureau of Economic Research and the American Enterprise Institute. What all of these organizations have in common is many staff members who worked for the election of President Bush, aided in the transition, and/or have moved to positions in the Bush administration. An emphasis on the individual as decision maker and/or locus of benefit program delivery is a common element in proposals from all of them related to all benefit program areas, including retirement. In terms of regulation, Republican leadership suggests an emphasis on reducing administrative costs and burdens (for example, efforts to speed pension plan exemption and qualification decisions). In addition, one might expect review of many regulations now in force to determine if they go beyond legislative intent. Under the Clinton administration, the PBGC spent a great deal of time "talking up" defined benefit plans and developing proposals to encourage the establishment and continuation of such plans (most of these proposals never got past the revenue police at the Treasury Department). Such an emphasis is highly unlikely during the Bush administration.

In terms of legislation, Republican leadership suggests a first priority on rate reduction and administrative simplification. Should there still be revenue available once rates have been reduced, then it suggests a first priority on raising limits on what individuals can contribute to retirement accounts and the amount that individuals can be paid from retirement accounts. It suggests an effort to expand IRAs and individual account plans, with an emphasis on lump-sum distributions and the portability of cash sums from one job to another, as opposed to an effort to expand defined benefit plans or annuity provision.

None of this will change between today and the 2004 election, even if the Democrats take back the House, retain the Senate, or both, in 2002. This is what the Bush administration philosophical grounding is, and that will as readily drive vetoes as it does proposals. The only thing that could change is the relative probability of any particular proposal making it through the full legislative process and becoming law. As President Clinton showed during a time of divided government, the power of the veto pen and having the soapbox of the White House are substantial. In addition, the administration does much of the meaningful staff work for its party on Capitol Hill. Even if Democrats took control of both the House and the Senate, they would be disadvantaged by not having staff from the administration, access to data and studies on an automatic and early basis, and the ability to coordinate strategy and announcements.

## THE ECONOMY AND PENSION POLICY

Consumption, not savings, drives the U.S. economy. The focus in the nation's capitol today is on keeping the economy growing. The Bush administration's recent focus was on tax reduction to spur consumption and rate reduction for the sake of the government keeping less money. Passage of the tax bill, followed as it has been by lowered government revenue estimates, makes it even less likely that there will be money available for added retirement incentive changes.

## CONCLUSION: THE BUSH ADMINISTRATION VALUES INDIVIDUAL CHOICE

Making voters happy today (with a high prospect of reelection) will always come out ahead of actions that might make voters happy in the future, but at the price of being miserable in the meantime (and lowering the prospects of reelection). This is, to be sure, a general statement on our history, not just on the Bush administration. It suggests that Social Security reform will be incremental. The incremental direction will continue to match the trend of the post-ERISA period: less paternalism and greater individual choice. And, it will now extend to Social Security. There is a libertarian bias in the Bush administration: Give people the room and freedom to make decisions, even if it leads to what some might normatively deem to be "bad" outcomes.

I have focused on the environment for policy making. I have underlined that all action is likely to be incremental. The career workforce at Treasury, the Internal Revenue Service, the Department of Labor, the Securities and Exchange Commission and other government agencies changed little as a result of the Bush election. These workers implement actions every day. New political appointees do not change their beliefs, attitudes and work habits, yet political appointees do make policy. Within the construct of current law, they can decide to not issue regulations, and they can determine the content of the regulations that are issued. They can decide to grant exemptions within the construct of the current law. They may well choose to interpret the law as allowing things that a Clinton appointee would have viewed differently. But the changes that can be made by administrative appointees are marginal and incremental. Neither retirement reform nor Social Security reform can be accomplished through regulation and enforcement.

Will the election of President George W. Bush lead to fundamental changes in pension policy, such as the elimination of employment-based plans? The answer is no. Will it lead to actions and overall directions—the relative role of the individual—that are different than would have been likely in a Gore administration? Here, the answer is yes.

How could President Bush make a major difference in pension policy? First, he could enact a flat tax or consumption tax. Either would greatly diminish or eliminate the tax advantages of tax-sheltered savings and capital accumulation. Second, President Bush could create a Social Security program based on individual accounts. An individually based Social Security program would change incentives for participation in employer plans and IRAs. The world would change. However, we will not experience such changes while George W. Bush is president unless the Republicans gain control of the Senate, with over 60 votes, and the House, with a margin of well over 100 votes. (And, these are not outcomes that any analysts are currently predicting.) The bottom line is: Don't expect significant retirement policy or Social Security reform until one political party is clearly in control of the government, or until the Social Security program is on the verge of not being able to send out the checks.[9]

*Editor's note:* This article draws upon the author's article "Perspective: The Bush/GOP Government and Retirement Policy: A Look at the Future," which appeared in Vol. 14, No. 2, of *Benefits Law Journal*, Summer 2001, and also from EBRI publications.

**Endnotes**

1. www.omb.gov.
2. www.commtostrengthensocsec.gov.
3. See www.ebri.org, www.nasi.org, www.csis.org, www.cato.org and www.heritage.org for lists of citations.
4. See surveys at www.ebri.org, www.nasi.org, and www.aarp.org.
5. Currently, in general, participants in a pension plan who are no longer working are required to take minimum distributions from their plans beginning at age 70½. If the full distribution is not taken, a 50% penalty tax applies to the amount that should have been distributed but was not.
6. Form 5500s are pension plan reports that plan sponsors must furnish to the government on a regular basis.
7. The Employee Retirement Income Security Act of 1974 (ERISA) requires defined benefit plan sponsors to pay premiums to the Pension Benefit Guaranty Corporation in exchange for insurance that protects participants' benefits (up to specified limits) in the event that the plan sponsor becomes unable to fulfill its pension promises.
8. See workforce and pension sections at www.heritage.org.
9. This is actually not what happens. The checks would be mailed; they just might bounce.