Social Security debate: It's back

Reforming the most popular entitlement program is once again on a lot of lips these days. But whether that translates into meaningful action is unclear.

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NEW YORK (CNNMoney.com) -- Federal Reserve chairman Ben Bernanke Thursday turned up the volume on the debate over Social Security reform - an issue that was declared dead last year but has been injected with new life in recent weeks.

In testimony to the Senate Budget Committee, Bernanke described the state of entitlement programs - which include Medicare as well as Social Security - as the "calm before the storm."

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"In particular, spending on entitlement programs will begin to climb quickly during the next decade ... (which) will put enormous pressure on the federal budget," Bernanke said.

In recent weeks, President Bush has asked Treasury Secretary Henry Paulson to reach out to Democrats to explore bipartisan solutions to Social Security's long-term funding shortfalls. Two Republican lawmakers - Senator George Voinovich (R-Ohio) and Rep. Frank Wolf (R-Va.) - said they will reintroduce a bill calling for a bipartisan tax and entitlement reform commission.

House Ways and Means Committee Chairman Charles Rangel (D-NY) and Senate Majority Leader Steny Hoyer (D-Md.) have indicated they are in talks with Paulson.

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And in his introduction to the Senate Budget hearing on Thursday, Committee Chairman Kent Conrad (D-ND) said he and Senator Judd Gregg (R-NH) are "committed to facing up to ... the challenges that we confront with Medicare and Social Security."

Bernanke in his testimony noted that federal spending on Social Security, Medicare and Medicaid will increase from 8.5 percent of GDP to 15 percent in 2030.

"Dealing with the resulting fiscal strains will pose difficult choices for the Congress, the Administration and the American people," said Bernanke. "However, if early and meaningful action is not taken, the U.S. economy could be seriously weakened."

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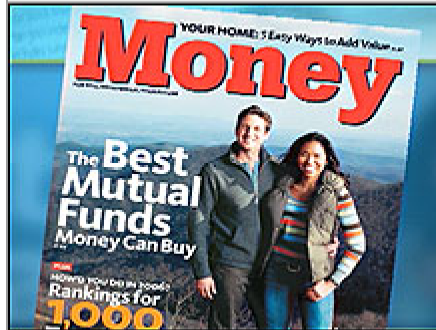

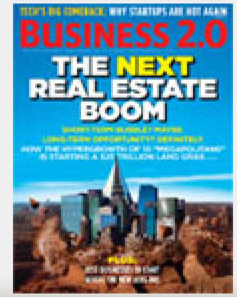

It's not yet certain that Social Security reform will be up for serious debate. For one thing, the war in Iraq may overshadow a lot of issues. Or, the Democrats and Republicans may prove unwilling to bend on critical issues.

Sticking points are likely to be the same as they were when the debate raged in 2005: The creation of individual investment accounts; increasing workers' Social Security taxes; and reducing promised benefits.

But nonpartisan observers such as the American Academy of Actuaries say a solution, if there is to be one, may well include some or all of the above.

"Every change will be painful," said Ron Gebhardtsbauer, the Academy's senior pension fellow. Because we're living longer and the ratio of workers to retirees is projected to go down during the height of the Baby Boomers' retirement, the current system will go out of sync unless something is done, he explained.

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Social Security taxes from today's workers go toward paying today's retirees. Social Security will continue to take in more money than it has to pay out through 2017, according to the latest calculations by the Congressional Budget Office (CBO).

To pay full benefits beyond that point, the program will tap its controversial trust fund - which is a series of special U.S. Treasury bonds issued by the federal government in exchange for the Social Security surplus it spends.

The trust fund is projected to run dry after 2046. After that, Social Security will only be able to pay 79 percent of promised benefits.

While the projected long-term shortfall in Medicare is about six times that of Social Security, the latter is considered more manageable to fix in the near term because its costs are more predictable.

Where some bending points may be

One change from 2005 is that the Democrats are now in the majority in Congress.

The Democrats still adamantly oppose President Bush's proposal to create "carve out" individual investment accounts, in which workers would divert some of their Social Security taxes to fund their accounts in exchange for lower Social Security benefits in retirement.

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But there may be something for both sides to like about "add-on" investment accounts, which would not divert money from Social Security.

One such type of account is the Portable, Lifelong Universal Savings (PLUS) Account proposed recently by Senator Jeff Sessions (R-Ala.), a member of the Senate Health, Education, Labor and Pensions Committee. Sessions proposes that the federal government contribute $1,000 into an individual account for every baby born. And when that person enters the workforce, she would invest at least 1 percent of her pay into the account and her employer would match that contribution.

Sessions also proposes that starting in 2009, every worker would have 1 percent on the first $100,000 of income automatically deducted and invested in a PLUS account along with an employer match.

Republicans may not like that the savings would be mandatory, and libertarians like Chris Edwards, tax policy director at the Cato Institute, label that kind of contribution a tax.

But it would satisfy part of President Bush's objective to create personal investment accounts, and it would satisfy Democrats' desire to increase workers' retirement savings without draining Social Security.

For those who object to mandatory contributions, a possible compromise, Gebhardtsbauer said, might be to only require that workers contribute to an add-on account if their employer does not provide them with a 401(k) or pension.

While add-on accounts don't address the shortfall issues in Social Security, they may allow for more serious consideration of some combination of fixes that are bound to rile one side of the aisle or another, but which actuaries, economists and deficit hawks say will be necessary if a long-term solution is to be reached.

These include:

- Increasing the retirement age slowly over the decades.
- Raising the payroll cap on the amount of wages subject to the Social Security tax. Currently, the first $97,500 of wage income are taxed at 12.4 percent (half paid by you, half paid by your employer).
- Progressive price indexing. Currently accrual of Social Security benefits are indexed to wage growth. Price growth is a lower measure by which to accrue benefits, and progressive price indexing would lower future benefits for middle- and high-income workers relative to what is currently promised, while leaving the promised benefits of low-income workers unchanged.

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