



President Bush's Social Security Privatization Plan: Benefit Cuts, Red Tape, and Increased Costs for Small Businesses

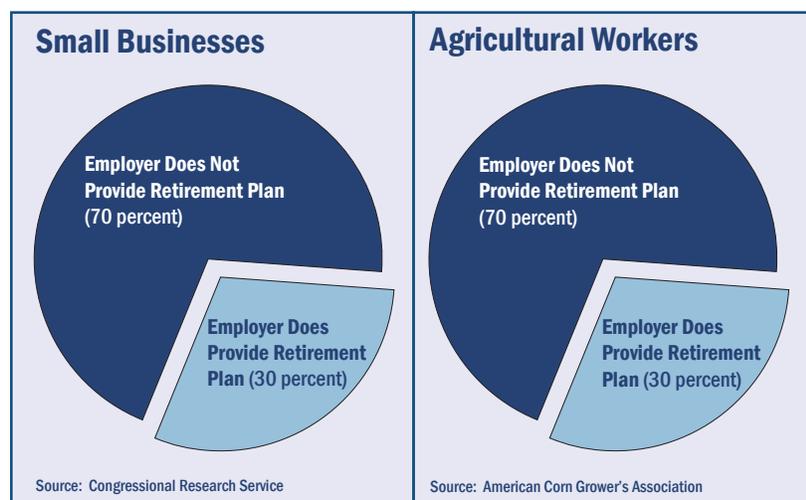


President Bush's Social Security Privatization Plan: Benefit Cuts, Red Tape, and Increased Costs for Small Businesses

President Bush's Social Security privatization plan would be a one-two punch for small businesses:

- ✗ cuts benefits for small business owners and employees (many of whom rely on Social Security as their sole source of retirement income); and
- ✗ burdens small businesses with increased administrative requirements and costs.

SMALL BUSINESSES ARE THE BACKBONE OF THE U.S. ECONOMY. Eighty-nine percent of all private employers in the United States have fewer than 20 employees. These firms range from family farms and hair salons to doctor's offices and professional consulting firms. Seventy-five percent of employers in rural areas have fewer than 20 employees. Minorities own more than 15 percent of the country's small businesses, with Hispanics representing the second fastest growing business group.



SMALL BUSINESSES ARE STRUGGLING TO COMPETE IN AN INCREASINGLY UNCERTAIN ECONOMIC ENVIRONMENT. The majority of small business owners earn less than \$75,000 per year and they can only afford to provide pension benefits for 30 percent of their employees. Already, small businesses spend 60 percent more per employee than larger firms to comply with federal regulations. According to the Small Business Ad-

ministration, the per employee cost of meeting federal regulatory requirements is \$6,975 for firms with fewer than 20 employees and \$4,463 for firms with more than 500 employees.

Minority-owned businesses have lower survival rates than the general population and rural enterprises face volatile business risks such as weather conditions that cause significant variation in income. Social Security is the only source of retirement income that many of these small business persons can rely on. Yet President Bush's privatization plan will cut Social Security benefits and burden small businesses with increased administrative costs to establish and maintain private accounts on behalf of their employees.

PRESIDENT BUSH'S BENEFIT CUT WOULD BE THE LARGEST IN HISTORY FOR SMALL BUSINESSES. Under the President's proposal, Social Security benefits for small

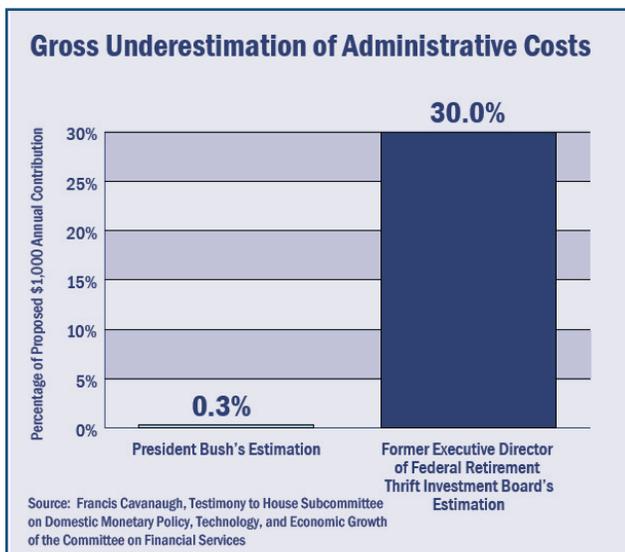
businesses will be cut in two ways—the indexing cut and the privatization tax for those who contribute to a private account. “The combined effect of progressive price indexing and the President's private accounts would be to reduce Social Security defined benefits by 73 percent for medium earners [who currently earn \$37,000] and 97 percent for the so-called ‘high earners’ [whose earnings today average about \$59,000].” (*Center on Budget and Policy Priorities*, 5/4/05; 5/2/05) In explaining the privatization tax, a senior Bush Administration official said, “...in return for the opportunity

to get the benefits from the personal account, the person foregoes a certain amount of benefits from the traditional system.” (*White House Office of the Press Secretary, Background Press Briefing on Social Security*, 2/2/05)

PRESIDENT BUSH'S PRIVATE ACCOUNTS WILL BE MANDATORY FOR SMALL BUSINESSES. While President Bush

Bottom Line Impact on Small Businesses	
Profits ↓	Account Start-Up Costs ↑
	Account Maintenance Costs ↑
	Contribution Correction Costs ↑
	Administrative Tasks ↑
	Regulatory Requirements ↑
	Employer Liability ↑

has said that private accounts would be voluntary for any worker who chooses to have one, he has failed to inform the public that private accounts would be mandatory for employers of these workers. Currently, small businesses have the option to provide employees with private investment accounts, but most small businesses choose not to offer retirement plans such as 401(k) or pension benefits. Under President Bush's plan, however, "Employers would not be able to avoid incurring any new administrative costs associated with individual accounts by declining to participate in the system because...as the President's Commission recommended, all workers who now participate in Social Security would be eligible to establish a Social Security individual account...All employers would have to accommodate the wishes of employees who wanted to establish Social Security individual accounts." (*Congressional Research Service, 2/3/05*)

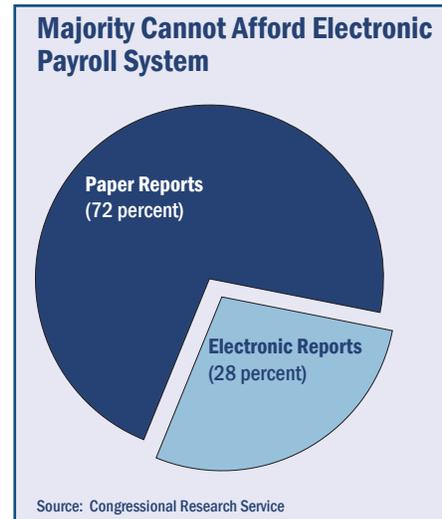


PRESIDENT BUSH HAS UNDERESTIMATED THE COST OF PRIVATE ACCOUNTS TO SMALL BUSINESSES. President Bush

claims the administrative costs of private accounts are 30 basis points or 0.3 percent. For small businesses, however, the cost would be much higher. According to Francis X. Cavanaugh, Former Executive Director of the Federal Retirement Thrift Investment Board, the cost of administering a private account per employee of a company with 10 employees would be \$300—30 percent of the proposed annual contribution of \$1,000. (Cavanaugh, *Testimony to House Subcommittee on Domestic Monetary Policy, Technology, and Economic Growth of the Committee on Financial Services, 5/5/05*)

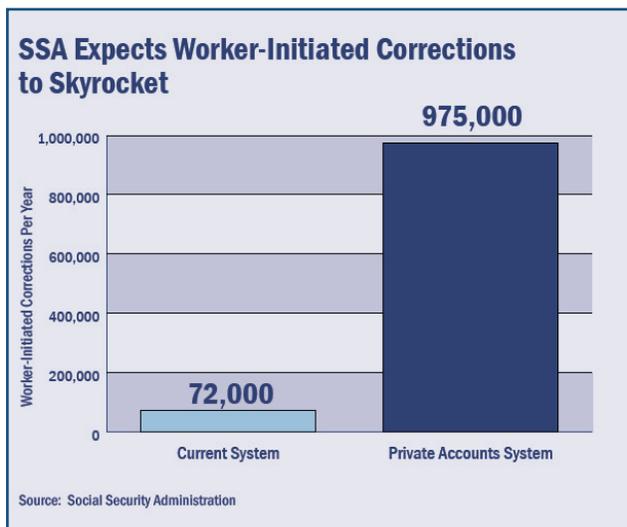
The President's estimate also

“doesn't reflect start-up costs, which the [Social Security Administration] said a few years ago could range from \$1.2 billion to \$2.3 billion” nationally. (*Wall Street Journal, 3/14/05*) President Bush has not indicated how much of these system start-up costs will be borne by small businesses.



PRIVATE ACCOUNTS WOULD BURDEN SMALL BUSINESSES WITH NEW, EXPENSIVE ADMINISTRATIVE REQUIREMENTS. Even if the government administered private accounts, small businesses would have to perform numerous new tasks on an ongoing basis to collect and report information about account contributions. These tasks include enrolling new participants, sending contributions to accounts, calculating contributions, identifying errors, calculating losses incurred as a result of mistakes, compensating financial losses due to errors, documenting activities as proof of compliance with applicable laws and regulations, and processing benefit claims in the event of job termination, retirement, death or divorce. Other tasks may include providing investor education, managing funds, and overseeing employee fund transfers. (*Employee Benefit Research Institute, 9/01*)

PRIVATE ACCOUNTS WOULD FURTHER COMPLICATE THE PAYROLL TAX SYSTEM AND REDUCE PROFITS. The current payroll tax system was designed to minimize administrative burdens on employers. Payroll taxes are reported only once per year on the Form W-4. The President's Commission noted that the existing system would cause a 15-month lag time in crediting contributions to private accounts. To eliminate this lag time, businesses would have to increase the frequency of payroll tax reporting to the Social Security Administration beyond once per year, file electronically, or both. Either way, these new costs would be borne disproportionately by small businesses because large employers are better equipped to deal with the proposed changes. In 2003, 72 percent of employers—mostly small businesses—submitted paper reports to the Social Security Administration (*Congressional Research Service, 2/3/05*). The Government Accountability Office (GAO) reported small businesses would face reduced profitability as a result of the required changes under the private account system. (*Government Accountability Office, 9/00*)



SMALL BUSINESSES WOULD BE SADDLED WITH NEW POLICING FUNCTIONS. The Social Security Administration expects the number of annual worker-initiated corrections in a system of private accounts to be about 975,000 per year compared to the current number of 72,000. (*Social Security Administration, 1/9/01*) This will result in employers spending a great deal more time and money reconciling errors with the SSA than they do under current law. In a system of private accounts, every penny invested affects the employee's

benefit amount. In addition to correcting mistakes with the SSA, small businesses may be held liable for any financial losses due to the reporting errors. The President has not made clear whether employers would take on a fiduciary responsibility with respect to handling employee account contributions, as ERISA (the Employee Retirement Income Security Act) currently requires in managing employee retirement funds such as 401(k) plans.

THE PRESIDENT'S COMPARISONS TO THE FEDERAL THRIFT SAVINGS PLAN ARE MISPLACED. President Bush has compared his plan for Social Security privatization to the administration of the Thrift Savings Plan (TSP), a retirement program for federal employees. The former Executive Director of the TSP, Francis X. Cavanaugh, recently testified before the House of Representatives that the President's comparisons between the TSP and private accounts are misplaced. "The TSP is administered by just one employer—the U.S. government—with extensive personnel, payroll, and systems staffs to provide the essential employee education, retirement counseling payroll deduction, timely funds transfers, and error correction functions." (*Testimony to House Subcommittee on Domestic Monetary Policy, Technology, and Economic Growth of the Committee on Financial Services, 5/5/05*) The TSP is an electronic system and similar economies of scale could only be achieved if all 6.5 million small businesses were merged into one large entity. (Employee Benefit Research Institute, *Are Individual Social Security Accounts Feasible?*, 1999)

PRESIDENT BUSH HAS FAILED TO ADDRESS SMALL BUSINESS CONCERNS ABOUT PRIVATE ACCOUNTS. In December 2001, the President's Commission to Strengthen Social Security acknowledged that a system of private accounts could impose new costs on small businesses. Since then, President Bush has failed to address the concerns small businesses have with his plan to privatize Social Security. No matter how a system of private accounts is set up, small businesses risk losing 40 percent or more of their Social Security benefits, profits, and valuable time and resources under President Bush's privatization plan.

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