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No. 1494 October 17, 2001

Social Security Reform Helps Small Business

James Morrison, Ph.D.

Small business has much to gain and very little to lose if Congress establishes Social Security personal retirement accounts. These accounts, which would allow taxpayers to invest a portion of their Social Security retirement taxes, would make capital more available to small businesses without adding any appreciable administrative burden. In addition, since Social Security benefits are more likely to fund a larger share of the retirements of small-business owners, reducing the program's impending financial problems is even more important to their financial security.

Social Security reform should be crafted with a recognition of the particular needs and vulnerabilities of small businesses and entrepreneurs. These can be explored in terms of two categories—concerns that affect the small business community as a whole and those related to the operation of specific businesses.

CONCERNS AFFECTING THE ENTIRE BUSINESS COMMUNITY

The debate over Social Security's coming financial problems involves concerns that, in addition to those that would affect the day-to-day operations of individual small businesses, would affect the small business community as a whole.

Greater Dependence on Social Security for Retirement Income. Employees of small businesses and entrepreneurs almost certainly will be more dependent on Social Security benefits than those entering retirement from larger enterprises. While 79 percent of mid- to large-size businesses offer employer-supported retirement benefits, far fewer smaller businesses do so.

The Impact of Marginal Taxes. Entrepreneurs (who already face high taxes) are probably more sensitive to changes in tax rates and tax structure than wage-and-salary workers are. Research indicates that a 5 percent increase in marginal tax rates leads to a 10.4 percent decrease in the probability of investment by those sole proprietors and that marginal tax rates that are high and progressive strongly discourage entry into self-employment and business ownership. Social Security taxes already have helped to drive marginal rates above 40 percent for many taxpay-

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ers. A taxpayer in the 28 percent federal income tax bracket, for example, typically pays 5 percent in state income taxes and 15.3 percent in Social Security and Medicare taxes.

Access to Capital. Allowing Social Security recipients to place a portion of their taxes in personal accounts that they own and control would initiate a "virtuous cycle" for capital markets. For one thing, it would create a favorable climate for balanced budgets or surpluses by reducing the government's unfunded liabilities. The experience of the past few years indicates that federal budgets that have surpluses instead of massive deficits are good for small business capital needs. Since 1998, small business has enjoyed the best access to capital on record, according to economic data tracked by the National Federation of Independent Business.

Creating personal accounts would have an effect not unlike creating employer-provided pensions. Capital would build up and would be put to productive use. Small business would benefit—directly, through investments from the funds themselves and, indirectly, through transactions with financial service intermediaries with access to the funds. Perhaps most important, personal accounts would dramatically improve the rate of return that entrepreneurs could expect on their payroll tax payments and thereby enhance their retirement income.

CONCERNS REGARDING OPERATIONS OF INDIVIDUAL BUSINESSES

The debate about Social Security reform also entails concerns regarding day-to-day business operations, one of which is the purported administrative burden that personal accounts would place on small business. It should be noted that major small business associations in the United States—associations that presumably have had ample time to study the issue—have been strongly urging Congress to enact personal accounts for years.

The "small business administrative burden" critiques often overlook or misinterpret the approach of the most widely accepted current proposals for personal accounts, which minimizes the administrative burden on employers. Most of the current proposals for personal savings accounts do *not* require employers to select investment funds or fund managers for their employees, set aside or independently deposit any funds, transmit any funds to workers, separately transmit any funds to the federal government, frequently submit information relating to personal accounts, choose annuities for workers, or bear legal or fiduciary responsibility for the performance of any of their employees' investments.

The proposals generally follow the example of the Thrift Savings Plan (TSP) that is currently available to federal workers. A portion of the employees' Social Security taxes would automatically be reserved by the Treasury Department for Social Security. This money would be deposited by that agency or the Social Security Administration into a "default" fund, indexing a large number of stocks, or purchasing low-risk Treasury securities, or both. As these accounts reached a specified size, workers would be able to choose from a group of carefully selected and regulated investment options. They, not employers, most likely would do so by checking a box on a form at the time of employment or later. As for the employer's "administrative burden," the most that any of the current proposals entail is an annual reconfirmation of the "box" that employees have checked. Employers who want to do more may do so.

The administrative "burden" on small businesses would be very minor under such a TSP approach, and small businesses stand to benefit substantially from Social Security reform that includes personal accounts. The energy invested in attempts to *mis*lead small-business owners regarding Social Security reform should be countered with efforts to provide leadership on this issue. That is the task of those who favor personal accounts.

—James Morrison, Ph.D., has specialized in small business and entrepreneurship policy for more than 20 years. He has worked for Congress, government agencies, international development organizations, and small business trade associations.

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WHY FOCUS ON SMALL BUSINESS?

Small business exercises an immense influence on the American economy. More than 99 percent of all U.S. employers are small, and they employ just over 50 percent of the private-sector work force. Such firms provide 75 percent of the nation's net new jobs and 50 percent of its private-sector economic output.[1]

But current statistics alone tell only part of the story. While larger businesses tend to create *process* innovations that strengthen economic efficiency, smaller businesses and entrepreneurs are responsible for the lion's share of *product* innovations that create new businesses and industries.[2] Technological developments that are likely to play a central role in future U.S. economic growth—such as biotechnology, lasers, and computer software—have been closely linked to smaller technology enterprises. This is an unusual feature of the American economy.[3] And it is not a new feature: A recent study of *Fortune* 200 companies has shown that 197 of them could be traced back to entrepreneurial founders.[4]

Small firms also are blazing trails in the rapidly globalizing economy. Between 1987 and 1997, the number of

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1. U.S. Small Business Administration, Office of Advocacy, *Small Business—Frequently Asked Questions*, August 2001.
2. Zoltan Arcs and David Audretsch, *Innovation and Small Firms* (Cambridge, Mass.: MIT Press, 1996).
3. Richard Nelson, *National Innovation Systems* (Oxford, UK: Oxford University Press, 1993).
4. Courtney Purrington and Kin Bettcher, *From the Garage to the Boardroom: The Entrepreneurial Roots of America's Largest Corporations*, National Commission on Entrepreneurship, August 2001.

U.S. small business exporters tripled to over 200,000, and these companies were 20 percent more productive—with 20 percent faster job growth and 15 percent higher wages—than the rest of America's businesses.[5]

At the same time, small business traditionally has provided a portal into the economic mainstream for younger and lesser skilled workers, the economically displaced, immigrants, and people leaving public assistance.

Consequently, Americans hold small business in very high regard. A 1997 Gallup poll found large majorities agreeing that small business represents "one of the best ways to get ahead in America" and saying that they admired small-business owners. Indeed, 92 percent of respondents said they would be pleased if a son or daughter started a small business.[6] These survey findings are essentially constant across age, ethnicity, gender, socioeconomic status, political philosophy, and partisan identification, and they are significantly more positive than the results of comparable surveys taken abroad.

Factors like these have led to an unusual degree of political and partisan comity on many national small-business issues. The substantial impact of small businesses in a broad range of arenas strongly suggests that it is economically, socially, and politically vital that small business be helped—or at least not harmed—by decisions that are made regarding the future of Social Security.

Reform should be crafted with a recognition of the particular needs and vulnerabilities of small businesses and entrepreneurs. These can be explored in terms of two categories—concerns that affect the small business community as a whole and those related to the operation of specific businesses.

CONCERNS AFFECTING THE ENTIRE BUSINESS COMMUNITY

The debate over resolving Social Security's coming financial problems involves considerations that affect all small businesses. In addition to concerns that would affect the day-to-day operations of individual small businesses, some factors would affect the entire small business community. These include:

- Greater Dependence on Social Security for Retirement Income. Employees of small businesses and entrepreneurs almost certainly will be more dependent on Social Security benefits than those entering retirement from larger enterprises. Most people in small businesses do not have pensions. While 79 percent of mid- to large-size businesses offer employer-supported retirement benefits, far fewer smaller businesses do so. Among businesses with 25–99 employees, the figure is 46 percent; for businesses with 10–24 employees, it is 34 percent; and for those with one–nine employees, it drops to 22 percent.[7]

  Despite efforts to encourage Americans to save adequate funds for retirement, most workers have not done so. Only 15 percent have saved more than $100,000, and only 30 percent have saved more than $25,000.[8] While some of those with higher savings may be younger workers, this still is very little money for periods of retirement that are likely to span 10–20 years. Figures on personal savings for retirement are not generally available by business size. However, a study by the National Association for the Self-Employed found that more than three-quarters (78 percent) of the entrepreneurs it represents had saved less than $100,000 for retirement even though virtually none of them had private-sector pensions and their median age was 46.[9]

5. Exporter Data Base, U.S. Department of Commerce, Office of Trade and Economic Analysis.
6. William J. Dennis, Jr., *The Public Reviews Small Business*, NFIB Education Foundation, 1998. Based on a 1997 Gallup poll of 1,108 American adults.
7. Employee Benefit Research Institute, *EBRI Notes*, Vol. 22, No. 1 (January 2001). Data compiled from U.S. Department of Commerce, Bureau of the Census, *Current Population Surveys*, March 1995–March 2000. The figures are for 1999.
8. American Savings Education Council and Employee Benefit Research Institute, *Retirement Confidence Survey*, 2001.

With generally inadequate pensions and personal savings, entrepreneurs would be seriously and disproportionately affected by Social Security benefit cuts—unless these cuts are offset by an increase in personal accounts or other reforms. At the same time, such benefit cuts would make retirement planning an even more daunting challenge for small business. Many would surely turn away from entrepreneurship in favor of "safer" choices—with damaging consequences for the nation's economic openness, growth, and innovation.

- The Impact of Marginal Taxes. Entrepreneurs (who already face high taxes) are probably more sensitive to changes in tax rates and tax structure than wage-and-salary workers are. Entrepreneurship entails risks, and those risks will not be taken without prospects for rewards that the entrepreneur regards as adequate.[10] Policymakers in Washington seem to grasp the importance of this "knife-edge" risk–reward calculus with regard to capital gains taxes but seem to ignore it when other taxes are being considered. Yet it is *marginal* tax rates—the taxes on that "next dollar" of income—that the entrepreneur must weigh regarding any and all revenue that cannot be treated as capital gains.

  This entrepreneurial calculus is apparent in a recent analysis of Internal Revenue Service data on sole proprietorships. Recent research indicates that a 5 percent increase in marginal tax rates leads to a 10.4 percent decrease in the probability of investment by those sole proprietors[11] and that marginal tax rates that are high and progressive strongly discourage entry into self-employment and business ownership.[12] Even the current level of Social Security taxes substantially distorts occupational choice and effort, as noted economist Martin Feldstein has demonstrated.[13]

  Social Security taxes already drive marginal rates above 40 percent for many taxpayers. A taxpayer in the 28 percent federal income tax bracket, for example, typically pays 5 percent in state income taxes and 15.3 percent in Social Security and Medicare taxes.

  For entrepreneurs, Social Security taxes are even more threatening than income taxes. The entrepreneur must directly pay both the employer's and the employee's share of the taxes and must do so whether it has been a good year or bad year—regardless of what the cash flows and accounts receivable may be, and regardless of whether or not the business makes a profit.[14]

  Absent reform, the Social Security-driven marginal rates for small-business owners could well exceed 50 percent. Payroll taxes left on "automatic pilot" would rise eventually by more than 33 percent, increasing the annual taxes on a couple earning $50,000 by more than $2,000.[15] It would be hard to overestimate the damage this would wreak on entrepreneurship and small-business ownership. Marginal tax rates that are well above 50 percent for even the smallest entrepreneur almost certainly would lead to a precipitous decline in new business formations.

9. National Association for the Self-Employed, *Social Security and the Self-Employed*, testimony, National Commission on Retirement Policy, Center for Strategic and International Studies, May 1997.
10. Douglas Holtz-Eakin *et al.*, "Horatio Alger Meets the Mobility Tables," *Small Business Economics*, Vol. 14, No. 4 (2000).
11. Robert Carroll *et al.*, "Personal Income Taxes and the Growth of Small Firms," in James Poterba, ed., *Tax Policy and the Economy* (Cambridge, Mass.: MIT Press, 2001).
12. William M. Gentry and R. Glenn Hubbard, "Tax Policy and Entry Into Entrepreneurship," Columbia University, Graduate School of Business, August 20, 2001, at *www.columbia.edu/~wmg6*. Using the 1979–1993 Panel Study of Income Dynamics, the research found, among other things, that the 1993 increase in the marginal tax rate lowered the probability for entry into self-employment by upper-middle-income households by as much as 20 percent.
13. Martin Feldstein, Richard T. Ely Lecture to the American Economic Association, *American Economic Review*, Vol. 86, No. 2 (1996).

Like other countries with punitive taxes on starting and running a small business, the United States could expect to see the growth of a large "informal" sector of entrepreneurial activity. As in those countries, such "gray market" businesses would not be able to enter into binding contracts, obtain loans or venture capital, advertise, hire more than a few employees, offer those employees any legal protections or mandated benefits, grow, or provide the government with the kind of data it needs to make rational economic decisions.

- Access to Capital. Small businesses need better access to capital than they historically have received. That is the resounding conclusion of three separate White House Conferences on Small Business over the past two decades. Hundreds of delegates to these conferences, elected by small-business owners themselves, indicated that "access to capital" was the number one small-business concern.

  Later, in the later 1990s, when this country's pace of business and technological innovation became the envy of the world, it was the agility and liquidity of American capital markets—exemplified by venture capital companies—that were widely identified as a linchpin for business development. While a large majority of small businesses are started with private savings or personal loans, most small business expansions depend upon banks and investors. For the whole system to work, small businesses must represent comparatively good risks for lending and investing, and sufficient capital to do so must be available.

  The decisions that Congress makes on Social Security will have far-reaching implications for capital access. A decision to do little or nothing in the immediate future means that Social Security will not become an even partially "prefunded" retirement program. Instead, it will remain a 100 percent "pay-as-you-go" system. Its multitrillion-dollar unfunded liability will remain unfunded.

  Given the country's likely demographic changes, additional debt and debt servicing costs would be almost inevitable. Government borrowing will compete with private borrowing and will almost certainly crowd out some of it. Interest rates are likely to rise higher, given the government's significant new

14. Entrepreneurs believe that they pay higher payroll taxes than wage-and-salary workers, and beliefs can affect economic behavior, but are their taxes *really* higher? Is there really a "payroll tax penalty on entrepreneurship"? Most economists say no. The prevailing view is that employers simply reduce the wages and benefits of employees enough to cover the employer's share of payroll taxes. Thus, wage-and-salary workers are said to shoulder payroll taxes equal to those of the self-employed. But do employers actually follow this formula? That seems to depend on two fairly shaky assumptions: that all employer costs are constant and that employers weigh all costs equally. One wonders how the theory would apply, for example, to the business environment of the late 1990s, which included robust economic growth, rising productivity, commodity deflation, and labor shortages. Why would a business "pass through" all employer payroll taxes to scarce and/or valued employees in such an environment when so many more amicable and less visible alternatives for cost recovery were available? A recent Gallup Organization poll of business owners casts additional doubt on the "employee pass through" view. The survey found that, even under the more difficult economic conditions and higher unemployment of mid-2001, fewer than one employer out of eight would freeze or cut employee wages and benefits as a response to increased payroll costs. In fact, the "pass through" option ranked a distant fourth to (a) absorbing the increased payroll costs through lower profitability, (b) laying off employees, and (c) raising prices. See William J. Dennis, Jr., ed., "Adjusting to Cost Increases," *National Small Business Poll*, Vol. 1, No. 4, National Federation of Independent Business, forthcoming 2001. By contrast, self-employed workers would tend to have much less flexibility in cost shifting. "Absorbing" a cost, when one is self-employed, usually means paying for it personally. And there is no one else to "lay off." Even "raising prices" is probably a less viable option, so the entrepreneur most likely pays the taxes. Thus, the "belief" of the self-employed that they are paying higher taxes than wage-and-salary workers—a "payroll tax penalty on entrepreneurship"—may well be more empirically true than is currently acknowledged.
15. President's Commission to Strengthen Social Security, *Interim Report*, August 2001. Congress and President Bush recently enacted a schedule of personal income tax rate reductions, in Public Law 107–16, that could partially offset these increases. However, most of those cuts are several years away, they could be changed by economic conditions or the outcome of elections during the intervening years, and they are scheduled to end in 2009.

demands on the capital markets, and this in turn will raise small businesses' costs of borrowing. If the political decision were made to use public debt to finance most or all of the coming Social Security shortfall, that additional debt would rise by approximately $47 trillion by 2075.[16]

Moreover, unlike borrowing to finance a transition to a prefunded system, borrowing to maintain the current system could never be repaid from Social Security tax receipts. The existing debt load exceeds $10 trillion, and the system's "pay–go" structure would continue making it larger, given the demographic shifts underway in the U.S. population.

Such an open-ended borrowing approach also would risk substantial inflation, in addition to which the sheer scale of the fiscal irresponsibility inherent in that approach could jeopardize the dollar's international standing in denominating debt and also as a "reserve" currency.

Financing Social Security debt out of general tax receipts (largely income tax receipts) most likely would lead to significantly higher income tax rates. As noted above, higher marginal tax rates are a serious hindrance to entrepreneurship and business ownership. Higher taxes, like reduced Social Security benefits, would take money from the pockets of individuals and companies, thereby shrinking personal savings and retained earnings as sources of capital.

But the United States need not pursue this ominous scenario of fiscal dead-ends.

A "VIRTUOUS CYCLE"

Allowing Social Security recipients to place a portion of their taxes in personal accounts that they own and control would initiate a "virtuous cycle" for capital markets.

For one thing, it would begin reducing trillions of dollars in unfunded liabilities,[17] which would create a favorable climate for balanced budgets or surpluses. If the experience of the past few years is any indication, federal budgets that have surpluses instead of massive deficits are good for small-business capital needs. Since 1998, small business has enjoyed the best access to capital on record, according to economic data tracked by the National Federation of Independent Business.[18]

For another thing, creating personal accounts would have an effect not unlike creating employer-provided pensions. Capital would build up and would be put to productive use. Small business would benefit—directly, through investments from the funds themselves and, indirectly, through transactions with financial service intermediaries with access to the funds. This process is succinctly summarized in a World Bank survey of global pension reform:

> [P]ension funds are critical players in "symbiotic" finance, the simultaneous and mutually reinforcing presence of many important elements of modern financial systems. They can support the development of factoring, leasing, and venture capital companies, all of which specialize in the financing of new and expanding small firms.[19]

The experience of Chile is instructive in this regard. Chile's Social Security personal account system is the world's oldest, dating back 20 years. Since then, the country has sustained robust economic growth averaging 7 percent a year, and both its capital markets and small businesses have flourished.[20] Among the more than 30 nations that have adopted personal accounts since then, none has reported a contradictory economic experience.

16. President's Commission to Strengthen Social Security, *Interim Report*. Data derived from *2001 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds*, Social Security Administration, March 19, 2001.
17. It is worth noting that the "transition costs" to a prefunded Social Security system are not "costs," strictly speaking, but rather the explicit recognition of these unfunded liabilities.
18. William C. Dunkelberg, ed., *Small Business Economic Trends*, monthly publication, National Federation of Independent Business, 1973 to date; see especially issues for 1998–2000.

Perhaps most important, personal accounts would dramatically improve the rate of return that entrepreneurs could expect on their payroll tax payments and thereby enhance their retirement income. Some of the most persuasive evidence of this dynamic is found in an analysis of the University of Michigan's long-running *Panel Study of Income Dynamics*. The analysis carefully tracked more than 200 independent business owners over a 35-year period. It showed that they could expect rates of return averaging about 3 percent to 3.5 percent within the Social Security system (in contrast to a 7 percent historical rate of return on equities). Over a working lifetime, 92 percent of the business owners would lose between $300,000 and $700,000 if they were to pay Social Security taxes rather than invest the same amount in a conservative portfolio of 50 percent blue chip stocks and 50 percent long-term government bonds.[21] Brighter retirement income prospects for small businesses and entrepreneurs would allow more people to take the many other risks that small-business ownership and entrepreneurship entail.

In sum, personal accounts offer two fundamental macroeconomic advantages for small business: what the government would *not* do (unnecessarily raise taxes, cut Social Security benefits, or borrow) and what the private sector *would* do (build up and deploy capital and improve retirement incomes).

The foregoing discussion has touched on four of the five basic options that the government could utilize to address Social Security's future financing needs. A fifth option would be to reduce other government spending sufficiently to cover Social Security's expected funding shortfalls.

Normally, this option might interest many small businesses, but the scale of the spending reductions required—perhaps $30 trillion to $50 trillion over time—renders it completely unrealistic. Funding for entire functions of government—for example, veterans programs, the administration of justice, transportation, space exploration, environmental protection—would have to be redirected. In 1994, in spite of the powerful mandate for belt-tightening evidenced by the Republican landslide, Congress barely summoned the political will to extinguish the Pennsylvania Avenue Development Commission. It would be utter fantasy to assume that Congress would opt to abolish entire departments on the scale of Transportation, Environmental Protection, or Veterans Affairs rather than borrowing, raising taxes, or cutting Social Security benefits.

Even if this were possible, moreover, it would send the wrong message: that every function of government should be subordinated to the imperative of providing retirement benefits. That is not a

19. Dimitri Vittas, *Pension Reform and Capital Market Development: "Feasibility" and "Impact" Preconditions*, World Bank *Policy Research Working Paper* No. 2414, August 2000, at *http://econ.worldbank.org/search.php*. Note, however, that this "virtuous cycle" would be disrupted if the federal government itself were to do the investing and own the equities. The government's investments presumably would include only the largest and safest companies, and the capital buildup would remain inside its treasury. Under such conditions, there would be no obvious point of access to the accumulated capital for entrepreneurs and small businesses. Even if there were, it would be problematic. The perils of political meddling in the selection of investments, worrisome enough with large and highly visible investments, would be magnified for smaller, more obscure investments. An equally profound danger would be federal government bias toward the larger companies in which the government held equity. That could adversely affect small businesses across a wide swath of issues—such as taxes, competition policy, intellectual property rights, and government procurement—where there is friction between large and small business interests.

20. "Chilean Social Security Reform as a Prototype for Other Nations," *EBRI Notes*, Vol. 18, No. 8 (August 1997), and Barry Bosworth *et al.*, eds., *The Chilean Economy: Policy Lessons and Challenges* (Washington, D.C.: Brookings Institution, 1994).

21. *The Impact of Social Security's Old Age and Survivors Insurance Program on Owners of Independent Businesses*, A Report of the Heritage Foundation Center for Data Analysis, October 25, 1999. It is important to note that this study was not based on a specific legislative proposal. Rather, it calculated Social Security's *historical* rate of return for a group of independent business owners from 1968–1993 and then compared that to a notional portfolio over the same period. Current legislative proposals for personal accounts would yield different results, because their investment parameters are different and because Social Security's *future* rate of return is expected to be well *below* the 3 percent to 3.5 percent found in the study. The study's underlying message—that personal accounts would yield better retirement incomes than an unreformed Social Security system—has been corroborated by additional nonpartisan studies by the Congressional Budget Office, the Social Security Administration's own actuaries, and others.

message that small-business owners (or, for that matter, any group of Americans) should want to be sent. As a prominent Democratic Party journal put it:

> [Democrats opposed to Social Security reform] should drop the motto "Social Security First" and start using "Social Security Only"—it more accurately reflects their position's logical endpoint. Democrats must ask themselves whether every other issue they care about—inner-city poverty, public schools, the environment, job training, universal access to health care—should be sacrificed or starved to maintain [today's] Social Security. If raising payroll taxes is part of the solution, exactly how much of a burden in regressive taxes on low-to-middle income Americans are Democrats willing to tolerate?[22]

CONCERNS REGARDING OPERATIONS OF INDIVIDUAL BUSINESSES

The debate about Social Security reform also entails concerns regarding day-to-day business operations, one of which is the purported administrative burden that personal retirement accounts would place on small businesses.[23] Before examining the substance of this assumption, it should be noted that major small business associations in the United States—associations that presumably have had ample time to study the issue—have been strongly urging Congress to enact personal accounts for years.[24]

While the "small business administrative burden" avenue of criticism has helped to identify various practical issues relating to the implementation of personal accounts, these critiques often overlook or misinterpret the approach entailed by the most widely accepted current proposals for personal accounts, which minimizes the administrative burden on employers.[25] Most of the current proposals for personal savings accounts do *not* require employers to:

- Select investment funds or fund managers for their employees;
- Set aside or independently deposit any funds;
- Transmit any funds to workers;
- Separately transmit any funds to the federal government;
- Frequently submit information relating to personal accounts;
- Choose annuities for workers; or
- Bear legal or fiduciary responsibility for the performance of any of their employees' investments.

In fact, the proposals generally follow the example of the Thrift Savings Plan that is currently available to federal government workers. Under this scheme, a portion of the employees' Social Security taxes would automatically be reserved by the Treasury Department for Social Security. This money would be deposited by that agency or the

22. Editorial, "Now for the Hard Part," *The New Democrat*, Democratic Leadership Council, Vol. 10, No. 6 (November 1998).
23. Kelly Olsen and Dallas Salisbury, "Individual Social Security Accounts: Issues in Administrative Feasibility and Costs," *EBRI Special Report and Issue Brief* No. 203, November 1998. This report also makes a number of other criticisms about the administrative efficiency of personal accounts that are beyond the scope of this paper but have been analyzed elsewhere. See, for example, Robert Genetski, *Administrative Costs and the Efficiency of Public and Private Social Security Systems, SSP* No. 15, Cato Institute, March 9, 1999.
24. For example, the membership of the ardently pro-personal account Alliance for Worker Retirement Security includes the National Association for the Self-Employed, the National Federation of Independent Business, and the U.S. Chamber of Commerce—three of the nation's largest small business associations—as well as small-business-dominated industry associations like the National Restaurant Association and the Printing Industries of America. It is equally striking that there have been no "eruptions" of small business discontent about administrative burdens in any of the more than 30 countries that currently offer some form of personal account.
25. See, for example, H.R. 2771 of the 107th Congress, introduced by Representatives Jim Kolbe (R–AZ), Charles Stenholm (D–TX), *et al.*, especially Part B, Subpart 1, Sections 251–253, 261–262, and 273, and Subpart H, Section 532. See also S. 2774 of the 106th Congress, introduced by Senators Judd Gregg (R–NH), John Breaux (D–LA), *et al.*, especially Section 2, Subpart B, Sections 251–254.

Social Security Administration into a "default" fund, indexing a large number of stocks, or purchasing low-risk Treasury securities, or both. As these accounts reached a specified size, workers would be given the option to choose from a group of carefully selected and regulated investment options. They, and not employers, would most likely do so by checking a box on a form at the time of employment or subsequently.[26]

As for the employer's "administrative burden," the most that any of the current proposals entail is an annual reconfirmation of the "box" that employees have checked. Employers who want to do more may do so. For example, under recently enacted law, employers may, if they choose, offer free investment advice to employees, and this advice is not treated as a taxable benefit.[27]

Indeed, it is significant that opponents' claims that private investments would bring excessive administrative burdens to employers (a potentially explosive criticism) have done little to reduce the strong support that small-business owners and entrepreneurs have registered for personal accounts. In one survey, the respondents were asked how they felt about being "required to help administer a Social Security account system" and whether they would be willing, at the extreme, to spend up to $1,000 per employee per year to implement a personal account system.[28] In another survey, respondents were told that employers would have to "separately deduct" the amounts for personal accounts and "deposit" these deductions "in a different place" from the taxes that are normally withheld for the federal government.[29]

Yet, despite these misleading or false assumptions regarding likely administrative burdens for employers, the majority of respondents to both surveys still favored personal accounts. Indeed, only 20 percent were less enthusiastic after having been told, in the first survey, that they would shoulder a significant administrative responsibility for the system. Only 16 percent found the "separate deposit" procedure described in the second survey to be a "very serious new burden"; 41 percent said it was "not very serious."

To anyone familiar with small businesses' typically strident reaction against government-mandated paperwork, these survey findings are nothing short of astonishing. They suggest not an ambivalence toward Social Security reform, but a powerful depth of conviction favoring it.

Although the survey questions described above may have been the result of genuine uncertainties about how personal accounts modeled on the federal Thrift Savings Plan (TSP) would work, descriptions of employer responsibilities given by opponents of Social Security reform have often been intentionally exaggerated and distorted. The truth is that the administrative "burden" on small businesses would be very minor under such a TSP approach and that small businesses stand to benefit substantially from Social Security reform that includes personal accounts.

CONCLUSION

The energy invested in attempts to *mis*lead small-business owners regarding Social Security reform should be countered with efforts to provide leadership on this issue. That is the task of those who favor personal accounts. They may find inspiration in the words of President Franklin D. Roosevelt:

26. According to a recent account of the Clinton Administration's planning for personal accounts, Treasury Department and Social Security Administration officials favored placing the "check-off" box on the face of the individual income tax forms (Form 1040). See Douglas Emendorf *et al.*, *Fiscal Policy and Social Security Policy During the 1990's*, paper presented at conference on "American Economic Policy in the 1990's," Harvard University, June 2001, p. 43.

27. Public Law 107–16, Title VI, Part 2, Subtitle F, Section 645.

28. Employee Benefit Research Institute, "The Small Business Community and Individual Social Security Accounts," *EBRI News Release*, April 16, 1999. Based on a survey of 500 small business owners in September–October 1998 by Matthew Greenwald & Associates, Washington, D.C. The survey presented three employer options for personal accounts, including an option similar to a TSP-style plan, but it strongly implied that all three options would be costly and intrusive for small businesses.

29. National Federation of Independent Business, *Small Business Assesses Social Security*, Washington, 1998.

Social Security is a "development towards [a] goal, rather than a finished product. [W]e should be constantly seeking to perfect and strengthen it in the light of our accumulating experience and growing appreciation of social needs."[30]

—James Morrison, Ph.D., has specialized in small business and entrepreneurship policy for more than 20 years. He has worked for Congress, government agencies, international development organizations, and small business trade associations.

30. Quoted in Senator John Breaux, "Rising to the Challenge," *The New Democrat*, Vol. 10, No. 6 (November 1998).