



AMERICANS FOR TAX REFORM

The Progressive Personal Account Reform Plan: The Official Score by the Chief Actuary of Social Security

By
Peter Ferrara

Last month, the Chief Actuary of Social Security produced an official score of a personal account reform plan I previously developed, published by the Institute for Policy Innovation (IPI).¹ That score shows that larger personal accounts, allowing workers on average to shift 6.4 percentage points of the 12.4% Social Security payroll tax to the accounts, would ultimately completely eliminate Social Security's long term deficits, without benefit cuts or tax increases. Indeed, the reform would produce enormous additional benefits for working people and the nation as a whole. Moreover, the score shows that the transition under such a reform plan would be feasible.

The main components of the reform plan are as follows:

- --Out of the 12.4% Social Security payroll tax, workers would be free to choose to shift to personally owned, individual accounts, 10 percentage points on the first \$10,000 in wages each year, and 5 percentage points on all wages above that, to the maximum Social Security taxable income (\$87,000 this year).
- Benefits payable from the tax free accounts would substitute for a portion of Social Security benefits based on the degree to which workers exercised the account option over their careers.
- Workers choose investments by picking a fund managed by a major private investment firm, from a list officially approved for this purpose and regulated for safety and soundness, similarly to the operation of the Federal Employee Thrift Retirement System.
- The accounts are backed up by a safety net guaranteeing that workers would receive at least as much as Social Security promises under current law.
- Apart from this personal account option, there would be no change in currently promised Social Security benefits of any sort, for today's seniors, or anyone in the future. Anyone who chooses to stay in Social Security would receive the benefits promised under current law. Survivors and disability benefits would continue as under the current system unchanged.

The official score of this reform plan shows:

- The large personal accounts in the plan are sufficient to completely eliminate the Social Security deficit over time, without any benefit cuts or tax increases. That is because so much

¹ Peter Ferrara, A Progressive Proposal for Social Security Personal Accounts, Institute for Policy Innovation, Policy Report 176, June, 2003

of Social Security's benefit obligations are ultimately shifted to the accounts. The accounts, in fact, produce a permanent surplus in Social Security by themselves.

- The accounts achieve this not only with no benefit cuts or tax increases in Social Security. Over time, in fact, the accounts would allow for large tax cuts, as well as substantially higher benefits. The official score shows that by the end of the 75 year projection period, instead of increasing the payroll tax to over 18% as would be needed to pay promised benefits under the current system, the tax would be reduced to 3.5%, *the largest tax cut in world history*.
- Moreover, at standard, long term market investment returns, the accounts would produce substantially more in benefits for working people across the board than Social Security now promises, let alone what it can pay. This is the only reform proposal that achieves that result.¹
- The reform also achieves *the largest reduction in government debt in world history*, by eliminating the unfunded liability of Social Security, almost three times the current reported national debt.
- The reform would also greatly increase and broaden the ownership of wealth and capital through the accounts. All workers would consequently participate in our nation's economy as both capitalists and laborers, and wealth ownership throughout the nation would become much more equal. The accounts would ultimately accumulate to about \$7 trillion in present value dollars, \$71 trillion in constant, inflation adjusted dollars. This would be *the largest expansion of personal wealth ownership for working people from any single reform in world history*.

The transition under the reform is financed by 4 factors:

1. Short term Social Security surpluses projected until 2018.
2. Reducing the rate of growth of Federal spending by 1 percentage point per year for just 8 years, and devoting those savings to the transition. The proposal would consequently involve a Federal spending limitation measure providing for this reasonable and moderate spending restraint. The proposal, therefore, provides a vehicle for beginning to get runaway Federal spending under control.
3. The revenue feedback from increased saving and investment in the accounts due to taxation of increased investment returns at the corporate level, as developed by Harvard Prof. Martin Feldstein and former Sen. Phil Gramm for his legislative proposal;
4. To the extent needed, the sale of surplus Social Security trust fund bonds. This just involves paying Social Security back for all the surpluses it has lent to the Federal government in the past for other government spending. Under the current system, those bonds are just going to be redeemed for cash from the Federal government anyway after 2018, until the trust fund is exhausted in 2042.

¹ The official score did not include any projections of the benefits payable from the accounts, but these would be the results at standard, long term market investment returns. See Ferrara, A Progressive Proposal for Social Security Personal Accounts, IPI, *supra*.

This transition financing burden is substantial, but quite manageable.

- With this transition financing, Social Security achieves permanent and growing surplus by 2029. Before that time an average of about \$52 billion in surplus Social Security trust funds bonds are sold each year for 24 years, for a total of \$1.25 trillion, all in today's dollars. *This represents the total net transition deficit under the proposal in constant 2003 dollars, after accounting for all of the financing provided under the reform.*
- Even with the sale of the surplus trust fund bonds, the trust fund never falls below \$1.38 trillion in today's dollars, or 145% of one year's expenditures, with the official standard of solvency being 100%. After 2029, the trust fund grows permanently, reaching 12.5 times one year's expenditures by the end of the projection period, or about \$6.3 trillion in today's dollars, far too much.
- Within 15 years after 2029, the reform produces sufficient surpluses to pay off all the bonds sold to the public during the early years of the reform. *So this surplus completely eliminates the Federal debt sold to the public in the earlier years of the reform, leaving the net impact of the reform on debt sold to the public at zero.* Indeed, as mentioned above, the reform goes on to completely eliminate Social Security's current unfunded liability of \$10.5 trillion, close to three times the reported national debt.
- After the bonds are paid off, the surpluses are used to reduce the payroll tax by 2.5 percentage points, and with 6.4 points on average going into the accounts, that leaves the payroll tax at 3.5 percentage points, the level needed to finance remaining disability and survivors benefits.

Reform proposals should consequently focus on large personal accounts of this magnitude, without benefit cuts or tax increases. Such large accounts not only solve the problems of Social Security. They provide additional enormous advantages for working people and the nation as a whole, much more than smaller accounts would. At the same time, the transition financing burdens for such accounts are entirely manageable.

This reform plan has now been endorsed by Jack Kemp and Empower America, Newt Gingrich, Steve Moore and the Club for Growth, Grover Norquist and Americans for Tax Reform, Charlie Jarvis and the United Seniors Association, David Keene and the American Conservative Union, former senior Reagan White House aide Robert Carleson, Lew Uhler and the National Tax Limitation Committee, Empower America senior economist Larry Hunter, Jim Martin and 60Plus, Kellyanne Conway, Tom Giovanetti and the Institute for Policy Innovation, and a growing list of others. It will be introduced in Congress by a coalition of Congressmen and Senators early next year.

Peter Ferrara is a Senior Fellow at the Institute for Policy Innovation, and President of the Virginia Club for Growth, as well as a special advisor on Social Security to the Club for Growth and the United Seniors Association.