

Social Security Personal Accounts: A Progressive Proposal for Reform

Many good books and studies have been written developing the rationale for allowing workers the freedom to choose a personal savings and investment account in place of at least part of their current Social Security coverage. What is needed now is a specific proposal for reform that delivers on the promise of personal accounts.

In a study to be released tomorrow by the Institute for Policy Innovation, Peter Ferrara proposes a specific, detailed, progressive reform plan that does precisely this. The plan provides a broad range of benefits for working people, lower income workers, African-Americans, Hispanics, women and ultimately all Americans across the board. The plan has already been publicly endorsed by Jack Kemp, Newt Gingrich, Grover Norquist and Americans for Tax Reform, Steve Moore and the Club for Growth, and Charlie Jarvis and the United Seniors Association.

The features of the reform plan include the following:

- Workers would be free to choose to save and invest in their own personal accounts 5 percentage points of the total 12.4% Social Security payroll tax (10 percentage points of the tax now go to finance retirement benefits). On the first \$10,000 of wage income, however, this would be doubled to 10 percentage points, including both the employer and employee shares of the tax. This would enable lower income workers to save a higher percentage of their incomes in the accounts than higher income workers.

- Those already in the work force when they exercise the personal account option would continue to receive a portion of the Social Security benefits promised under the current system based on the taxes they and their employers paid into the system in the past, in addition to the benefits from the personal accounts. This would ensure these workers would be able to gain the benefits of the reform as well.

- The Treasury Dept. would contract with a number of private fund managers to offer investment funds to workers who exercised the personal account option, as in the Federal Employee Thrift Savings program. Other investment firms can apply to the Treasury Dept. to have their investment funds added to the list. These funds would be subject to Treasury regulation requiring diversification of assets and other safety measures. Workers exercising the personal account option must choose among these alternatives on the Treasury Dept.'s list for investment of their funds. The worker would

consequently only have the responsibility of choosing among these funds, and the fund managers would pick the particular stocks, bonds or other investments.

-- The entire system would be backed up by a safety net providing a guaranteed minimum benefit equal to at least what Social Security would have paid without the account.

-- There would be no change in current benefits for those retired today. Future Social Security benefits for those who did not exercise the option would not be changed by this legislation either. Workers would be free to choose to stay in the current Social Security system as is.

-- Social Security disability and pre-retirement survivors benefits would continue to be provided by the old Social Security framework as today, and would not be affected by the personal accounts.

-- The transition would be financed through current Social Security surpluses, the extra taxes produced through higher savings and investment and higher economic growth, and reductions in the growth of other Federal spending. Indeed, just reducing the rate of growth of Federal spending by one percentage point per year would, along with the other factors mentioned above, probably eliminate the net transition deficit from the reform within 15 to 20 years, leaving net surpluses from the reform thereafter.

-- Before that point, the net remaining transition deficit each year after the factors above would be financed by issuing Federal bonds in an off-budget Federal account. The account would consequently not be part of the annual deficit or surplus calculations in the general Federal budget, and would not be a factor adding to the reported deficits each year. These bonds do not involve new government debt, but just explicit recognition of the effective debt already existing in the unfunded liabilities of Social Security. These bonds could then be paid off over a period of 30 years or so, using the surpluses ultimately generated by the reform as discussed above.

This reform plan would provide enormous benefits for working people across the board, and for the nation as a whole:

-- The accounts would allow workers personal ownership and control over their retirement funds and broader freedom of choice. Workers could choose among investment funds managed by major investment firms. They would have more choice over their retirement age, and could choose to leave substantial funds to their children or other heirs. They would also be free to choose whether to exercise the personal account option or stay entirely in the old Social Security framework.

-- Social Security's aging pay-as-you-go system offers today's workers a low, below market return on the taxes they and their employers pay into the system. For

many, the return is zero or even negative. These workers would now be able to get far higher returns and benefits relying on diversified investments in the capital markets. Exercising such an account option over their entire working lives and earning just standard market investment returns on a diversified portfolio of stocks and bonds, workers across the board would retire with 60% to 75% more in benefits than Social Security promises, but cannot pay.

--Because of the progressive nature of the reform proposal, with lower income workers again able to contribute a higher percentage of their incomes to the accounts than others, the net gain for lower income workers would be in this same range as well.

-- African-Americans would gain more than other workers because of their lower life expectancies. Annuities can be designed for this group to pay them even more in benefits for the fewer years they live in retirement on average. If they die before retirement, they can leave the accumulated account funds to their children or other heirs.

-- Hispanics would gain more than other workers on average because as a group they are younger than the rest of the population, and Social Security provides lower returns the younger a worker is. Earning the same market returns as everyone else with a personal account, they would gain more on average as compared to Social Security.

--At the same time, such a strong, substantial, personal account option will unwind the long term Social Security deficits, and eliminate the program's unfunded liabilities, with nothing more than the positive features of the personal accounts. As the years go by, workers will be retiring relying more and more on the real savings and investment in the accounts for their benefits, and less and less on the old Social Security framework. This process would sharply reduce the benefit obligations of the old system, reducing the program's deficits and unfunded liabilities. If almost all workers ultimately exercise the personal account option, eventually we would reach the point where virtually all workers are relying on personal accounts for their retirement benefits in place of the old Social Security framework. At that point, the old Social Security system would bear little or no benefit obligations, and there would consequently be no deficit or unfunded liability of any consequence in that old system.

--The current unfunded liability of Social Security, at \$10.5 trillion, is about three times the reported national debt. Yet, that unfunded liability is effectively government debt today, a promise that the government owes under current law. Eliminating that \$10.5 trillion obligation would in fact be the biggest reduction in government debt in world history.

-- Since capital market returns are so much higher than what Social Security can pay, the required payments into personal accounts can be substantially less than current Social Security taxes. This would ultimately amount to a major tax cut for workers and their employers as workers come to rely on such accounts for the bulk of their Social Security coverage. Indeed, over time the reform would transform public Social Security taxes into private retirement payments by workers and their employers into each worker's

privately owned personal savings and investment account. This would effectively amount to the largest tax cut in world history.

--As a result, the reform plan not only eliminates the long term Social Security financing crisis without cutting Social Security benefits or raising taxes. In the end, workers would enjoy higher retirement benefits and lower taxes.

-- The reduced tax burden and higher savings and investment resulting from personal accounts would substantially boost economic growth. This would result in more jobs, better jobs, and higher wages and overall income.

-- Such personal accounts would also provide low and moderate income earners their only real chance to participate in investment markets like higher income workers, and accumulate substantial savings and capital. This would result in much broader and much more equal ownership of wealth and capital, which would greatly enhance social solidarity and harmony. There would no longer be a division between labor and capital in society. Everyone would be both a laborer and a capitalist. Indeed, the reform would bring about the ultimate socialist dream of the nation's business and industry being owned by the workers. But it would do so through capitalist means.

Under this reform plan, a broad social framework remains in place to ensure that working people will be able to take care of their retirement needs, including the continuation of a generous social safety net. The plan consequently really involves expanding and modernizing the Social Security framework to bring in a role for personal ownership and control, and real savings and capital investment, and better serve working people.

The long term goal is to expand the support for this reform plan across the whole conservative movement, to truly progressive liberals and Democrats, and ultimately to the President of the United States and Congressional leaders from both parties.