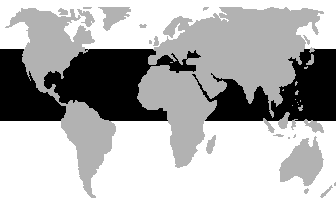

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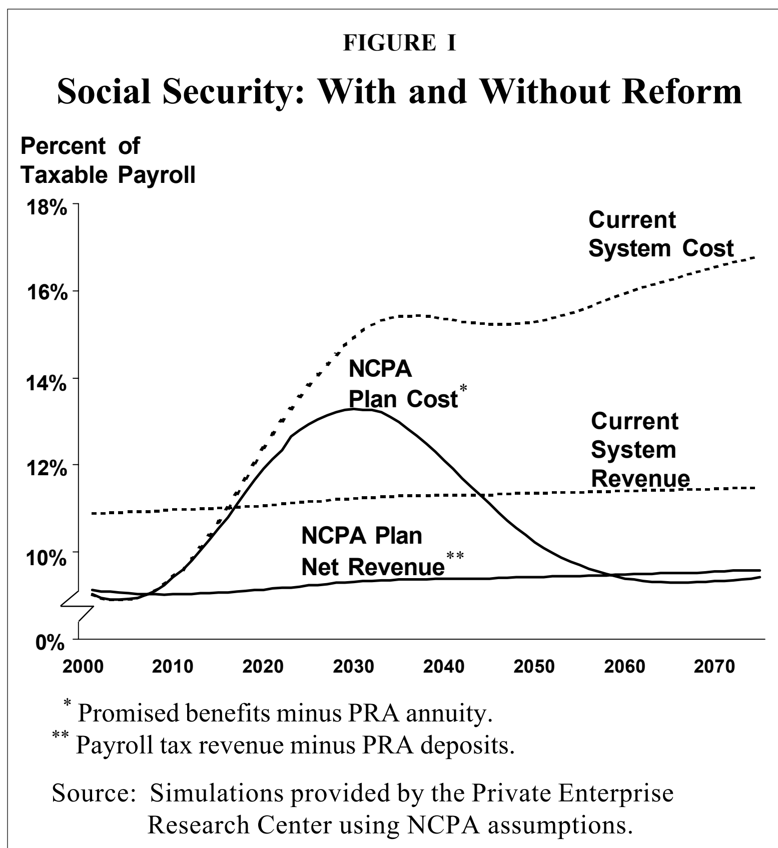
# How to Save Social Security

**by John C. Goodman and Matt Moore**

President Bush's bipartisan Social Security reform commission delivered its final recommendations for repairing Social Security in December 2001. The commission asked for a year-long dialog on reform to help the American people better understand the difficult choices ahead and to build public and congressional consensus around a particular solution. Unfortunately, politics has pushed reform to the back burner. And while Congress dawdles, the problem grows.

**The Case for Change**. Social Security is currently running a surplus. However, these days of plenty are in short supply. In just 15 years, Social Security will pay out more than it collects in taxes. In each following year, the deficit will grow larger. Over the next 75 years, Social Security faces a total debt of $25 trillion (measured in current dollars). If taxes stay the same, benefits must be cut by up to a third for future retirees. If benefits stay the same, taxes must rise by half to cover the gap.




* Promised benefits minus PRA annuity.
** Payroll tax revenue minus PRA deposits.

Source: Simulations provided by the Private Enterprise Research Center using NCPA assumptions.

Opponents of reform say we should not tinker with Social Security. But in saying that they implicitly are endorsing a cut in Social Security benefits for baby boomer retirees and all subsequent generations. The reason? Current law requires that Social Security benefits be limited to the program's income. That means in 2041 — when all the Treasury IOUs in the trust fund have been reclaimed — and in each year thereafter benefits will have to be cut to match payroll tax revenues.

**A Solution: Personal Retirement Accounts**. A plan developed by the National Center for Policy Analysis (NCPA) combines the most attractive features of major proposals by both Republicans and Democrats over the past several years. It allows younger workers to deposit two percentage points of their current 10.7 percent Social Security tax in a personal retirement account (PRA) that they would own and control. Workers would choose from a select number of portfolios that reflect the market as a whole — 70 percent stocks/30 percent bonds — sponsored by government-approved fund managers.

Upon retirement, individuals could purchase a variable annuity, holding the same diversified portfolio as in pre-retirement. Participating retirees would receive two monthly benefit checks: one from a PRA and another from the government to bring benefits up to currently scheduled benefit levels.

The NCPA proposal assumes a dollar-for-dollar offset. Each dollar in an individual's account reduces the government's obligation by a dollar. For the first several decades under the new plan, annuities would not play a significant role. But in the future, account balances will be large enough to annuitize the scheduled benefit.

**No Benefit Cuts**. Without reform, Social Security promises will exceed Social Security income beginning in 2017. The gap between the two will grow indefinitely into the future. [See Figure I.] Many reform plans also call for explicit or implicit benefit cuts. These include raising the retirement age and changing the cost of living adjustment. Under the NCPA's suggested reform, Social Security would be able to pay promised benefits with the current tax rate by the time today's teenagers retire.

**No Permanent Tax Increases**. Without reform, taxes will have to increase by up to 50 percent if Social

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Security is to continue paying full promised benefits. With reform, taxes will equal benefit payments by 2058, and Social Security will run annual surpluses in each year thereafter. Some additional funds will be needed to pay full benefits between 2008 and 2058. Our simulation assumes the government makes up the difference by borrowing.

**No Downside Risk**. Some reform plans would give individuals a great deal of discretion in selecting their retirement account portfolios. This grants participants a high degree of individual choice, but also exposes inexperienced or aggressive investors to added risk. The NCPA approach would reduce individual discretion, but eliminate downside risk through a government guarantee that retirees would receive scheduled benefits by forfeiting upside gains.

Workers would choose from a list of government-approved-and-supervised fund managers, each of which would offer a balanced, diversified portfolio that tracks the market as a whole. From day-to-day and even year-to-year the market fluctuates widely, but over the long term, the market always makes positive gains:

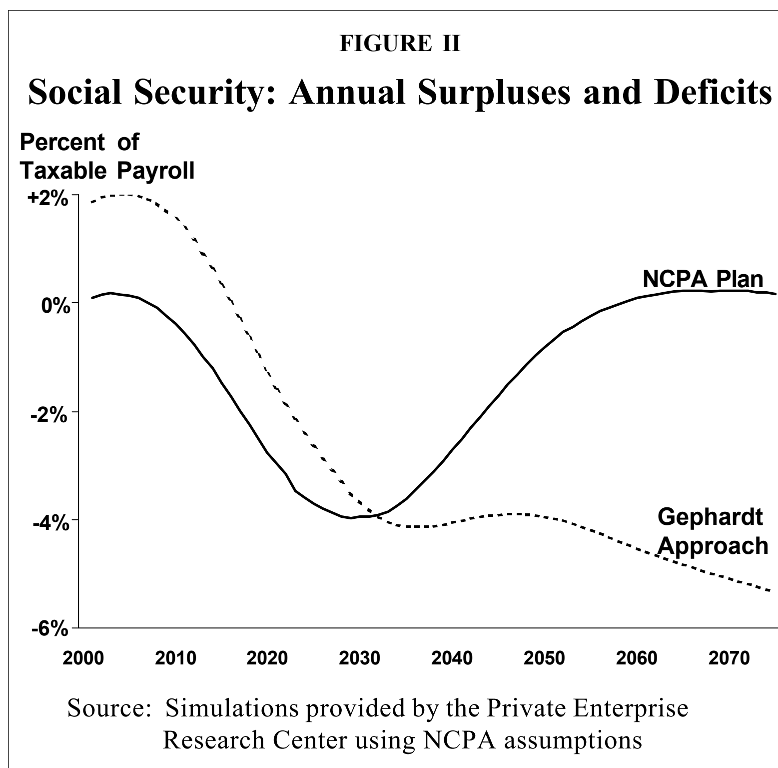
- For example, in all of the 35-year periods over the last 128 years the market has yielded an average annual 6.4 percent real rate of return.
- Even the lowest-earning 35-year period, which ended in 1921, yielded an average real rate of return of 2.7 percent, which is higher than Social Security's meager 2 percent rate of return on payroll taxes.

**No Long Run Deficits**. While some borrowing in the short term will be necessary to bridge the transition, our analysis shows that Social Security would be able to pay its own way by 2058 and thereafter. Opponents of reform — including Rep. Richard Gephardt (D-Mo.) and others — propose to use the Social Security surplus to pay down the publicly held debt during the surplus years and borrow the money back once deficits appear again.

- By 2031 the debt under the Gephardt approach would be back at the same level it is today.
- By 2058, when the NCPA reform plan begins running surpluses, the Gephardt approach would be mired in increasing annual deficits. [See Figure II.]
- By 2075, the national debt would be vastly greater under the Gephardt approach than under the NCPA reform plan.

FIGURE II

**Social Security: Annual Surpluses and Deficits**




Source: Simulations provided by the Private Enterprise Research Center using NCPA assumptions

**Voluntary Participation**. Participation in the new system would be voluntary. Workers who choose to remain with the current system may do so, but they must accept lower monthly benefits as a result as the old system's finances deteriorate through time.

**Other Benefits of Reform**. There are additional reasons to adopt this reform. First, participants could leave the balance of their personal account to their heirs. Second, because the NCPA approach requires dual earner couples to share family earnings between their accounts equally, working women and divorcees would not be penalized. Third, workers would be able to choose their own retirement age, accepting lower monthly benefits for early retirement and higher benefits for delayed retirement.

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