

**BRIEF ANALYSIS**

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## Social Security Reform: The NCPA's 'Hybrid' Plan

By John C. Goodman

President Bush's Commission to Strengthen Social Security moved the Social Security reform discussion forward. However, despite the commission's hard work, its findings are not the final word in the debate. As Congress takes up the discussion, it should consider the "hybrid" reform plan proposed by the National Center for Policy Analysis. The NCPA plan combines the most attractive features of major plans developed by both Republicans and Democrats over the past several years. It includes no benefit cuts for those who contribute to a personal retirement account (PRA) and no tax increases.

If Congress establishes personal accounts as prescribed in this plan, administrative costs can be minimal, benefits can be guaranteed and the long-run funding problem in Social Security can be solved.

**How Personal Retirement Accounts Would Work.** The NCPA plan gives workers the opportunity to deposit two percentage points of their current 12.4 percent Social Security tax in a personal retirement account (PRA) that they can own and control.

■ **Investments:** Accounts would be invested in a portfolio that reflects the market as a whole: 70

percent stocks/30 percent bonds. This allocation would be held throughout retirement, so that the retiree continues to benefit from high capital market returns.

■ **Fund Managers:** Workers would have the opportunity to choose from a list of government-approved fund managers.

■ **Guarantees:** The federal government would guarantee Social Security benefits promised under current law to every worker

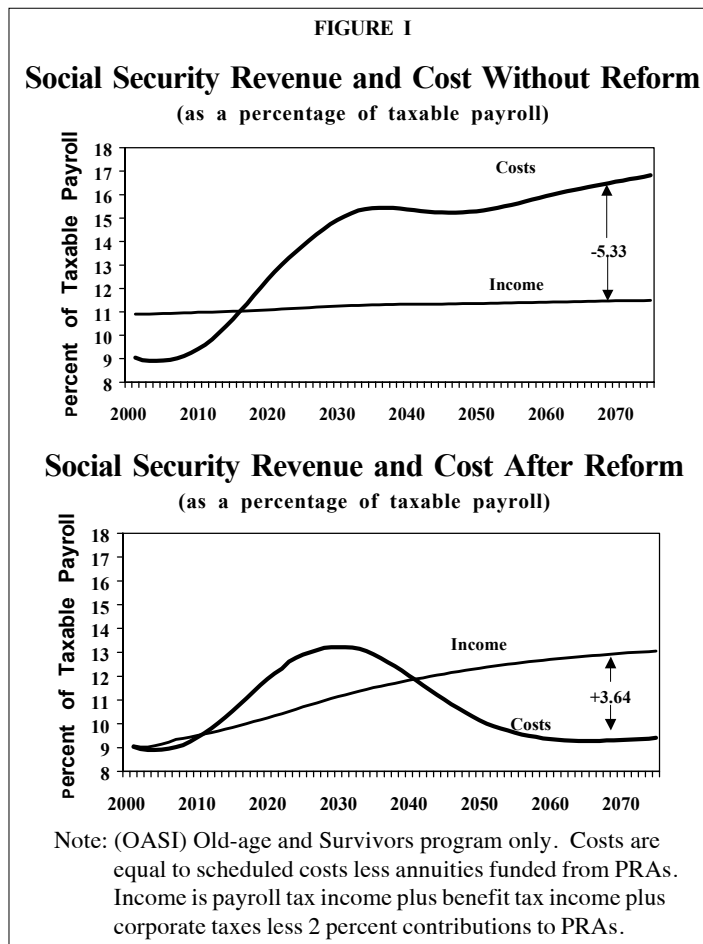
choosing to participate in the new system; further, the benefits of current retirees or near-retirees would be unaffected.

■ **Monthly Benefit:** Upon retirement, every retiree would receive two monthly benefit checks: one from a PRA and another from the government to bring benefits up to the guaranteed level. Since market returns vary from year to year, the government's payout would also vary; our simulation assumes the government makes up the difference by borrowing and lending.

■ **Annuities:** For the first several decades under the new plan, annuities would not play a significant role. However, in the future, if account bal-

ances are large enough to annuitize the guaranteed minimum benefit, retirees who choose to do so could use the remainder of their account for other purposes.

■ **Inheritance:** In case of an early death, dependents could inherit a worker's PRA funds, provided they



are not needed to pay any of the worker's dependents' promised benefits.

- **Incentives:** Although workers who choose the PRA option would have a guaranteed benefit equal to what they are promised under current law, those sticking with the current system would not have this guarantee.
- **Treatment of Women.** Married couples would be required to divide their PRA funds equally in separate accounts at the time contributions are made. Each spouse would also be guaranteed the minimum benefits currently promised.

**Keeping Administrative Costs Low.**

We estimate that administrative costs on the NCPA's personal accounts can be held to 0.2 percentage points. To achieve this goal, the Social Security Administration would be responsible for collecting employee data, making deposits and administering accounts for employees of small businesses and firms that do not have automated payroll. Thus, these businesses would face no additional administrative burdens. However, large businesses and those with automated payroll could administer the accounts themselves, much as they administer 401(k) and 403(b) employee retirement plans today.

Smaller deposits could be pooled into large, generic funds until they grow to about \$500 to \$1,000, when they would be large enough that funds would want to compete for them. Once the accounts were transferred out of the generic funds, account holders

would have more options. Investors would be able to check earnings daily in newspapers and continuously online.

**Saving Social Security: Long-Term Costs and Benefits.** The long-term costs and benefits of the plan were calculated with a computer simulation model developed by the Private Enterprise Research Center at Texas A&M University and the NCPA. The same model was used to assist members of the President's Commission in devising plans of their own. According to estimates derived from the model:

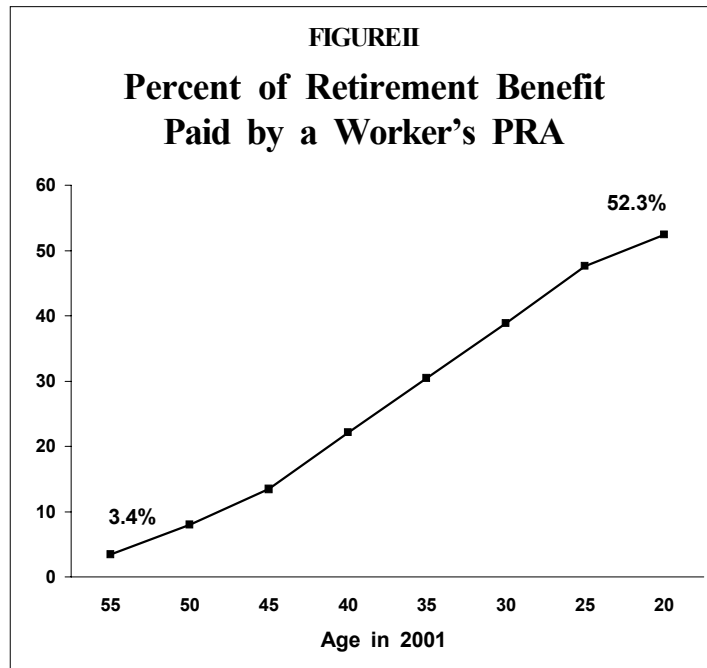
■ Without reform, by 2070 Social Security's expenses (the retirement portion only) will exceed income by 5.33 percentage points of taxable payroll, almost half of the program's income in that year. [See Figure I.]

■ By contrast, under the NCPA plan Social Security's annual income will exceed its annual outgo by 2058; in 2070 the program will run an annual surplus of about 3.64 percent of taxable payroll.

According to the model's calculations, a 20-year-old worker can expect to receive more

than half of his retirement income from his personal retirement account — assuming a real rate of return on the account of 5.4 percent each year. [See Figure II.] This makes it possible to fund personal accounts without raising taxes on future workers or cutting benefits for future retirees.

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