The Committee for Economic Development (CED) is an independent, nonpartisan organization of over 200 business and education leaders, principally CEOs of business firms or universities. For over half a century, CED’s trustees have produced policy statements from the perspective of the national interest on major economic and social issues. In 1997, after a year of study by a committee of its trustees, CED released Fixing Social Security.

**The Problem** CED found that Social Security faces two fundamental problems — fiscal insolvency and political insolvency. Fiscally, promised benefits cannot be delivered in the long-term under the present funding structure. Politically, current contributors, especially younger workers, are increasingly dissatisfied with the low and declining returns from their payroll tax contributions. As a result, they view social security as a “bad deal,” and their political support for the system is waning. We believe that any viable reform effort must address both these problems.

**CED’s Principles for Reform** CED trustees first defined a set of principles and objectives for reform. We recognized that there are no easy fixes, that trade-offs between objectives are inevitable, and that some sacrifice is required. However, we concluded that, to the greatest extent possible, reform should:

- Provide a guaranteed minimum retirement income, or safety net, for all workers and their families, retaining an element of income redistribution to support this safety-net;
- Reduce inequities between generations, principally by raising returns for younger workers, and also improve equity among beneficiaries, particularly between workers with non-earning spouses and other retirees;
- Increase national saving and investment, which will be required to provide adequately for both the rising number of elderly and the relatively small number of workers who will help support them;
- Require universal participation, so that the burden of the redistribution and insurance elements of social security be shared as broadly as possible;
- Be enacted promptly but phased in gradually to provide ample time for planning for and adjusting to changes in retirement arrangements;
- Hold down administrative costs, including any arising from investments in private assets.
CED’s Recommendations  To address the dual problems of fiscal and political insolvency, CED recommends a two-tier solution:

1. **Restore solvency to our current basic benefit system**  The current payroll tax would be preserved. While retaining a basic retirement safety net for low-income workers, future payments to middle and upper income beneficiaries would be modestly reduced by slowing the growth of initial benefits, raising the normal retirement age to 70, increasing years of covered employment required for full benefits from 35 to 40, and taxing benefits in excess of contributions, as is done now for private pensions.

   These changes would have little or no effect on current beneficiaries or older Americans near retirement. However, they would be substantially more than required to restore 75 year actuarial balance to the trust fund. We believe that such a “safety margin” is appropriate in light of the history of optimistic projections of the trust fund balances and in order to maintain such actuarial balance over an extended period. If the safety margin proves unnecessary, the benefit changes can be modified or payroll taxes reduced.

2. **Raise the rate of return on contributions by establishing a “second tier” of privately owned personal retirement accounts (PRAs)**  These accounts would be funded by mandatory contributions of 3 percent of payroll, half from employees and half from employers. The contributions would be made from pre-tax income (as in 401 (k) plans) and annuitized upon retirement. PRAs would be privately owned and managed, but investment options would be limited to hold down administrative costs.

   We consider the private ownership and management of these accounts -- putting them beyond the reach of government -- to be a critical feature of the program. Public ownership and/or control of these funds entails the risk that the government will contrive to spend them, as continues to be the case at present, our new unified budget surplus notwithstanding. In addition, public investments in private securities would place the independence of the private sector in serious jeopardy. These investments would be extremely large, giving the federal government an effective controlling interest in many private companies. We doubt that government could permanently resist the temptation to pursue political and social objectives through its investment policies.

Comparison With Other Proposals  In designing this program, CED’s trustees rejected other proposals that fell short with respect to some of the basic principles and objectives listed above:

- **CED rejected tax increases** which would reduce rates of return, increase intergenerational inequity, and weaken political support for social security. Payroll tax increases would also tend to reduce employment and economic growth.

- **CED also rejected privatization of the basic system**, which would abandon the principle of social insurance and impair our retirement safety net. Privatization would also create enormous transition costs that would entail unacceptable increases in deficit financing or commensurate tax increases. Partial privatization plans that would “carve out” a significant portion of the current payroll tax to fund private accounts suffer in some degree from these same shortcomings.
My comments are given from my position as Manager of a community of 50,000 population, as a Commissioner of the Massachusetts Public Employee Retirement Administration Commission (PERAC), and as Chairman of the Social Security Committee for PERAC.

Obviously, there is no doubt that our Social Security System needs changes in order to remain solvent and to continue to pay benefits to the participants of the system. Furthermore, these changes should be implemented sooner rather than later.

As you know, the Social Security System is a pay-as-you-go system rather than a funded one. I do not believe that the long-term solution is simply to keep increasing the Social Security tax on payroll and/or increasing the retirement age. We need to invest part of the Social Security funds in equities managed and invested by a Board of Trustees independent of the administration and Congress. It has been demonstrated that even a modest return of 8% over the long-term will basically keep the Social Security System solvent in the future.

There has been discussion of including the seven states, which are currently not part of the Social Security System into the system. We are opposed to this idea.

We in Massachusetts have an excellent public pension system, which we do not want to lose. Our system was created several years prior to the Social Security System in 1935. We were subsequently given a choice of whether to join the Social Security System or retain our own system, and we chose the latter. The Massachusetts public retirement system is established under the General Laws and is governed by a seven-member commission, the Public Employee Retirement Administration Commission. PERAC oversees 106 individual retirement boards throughout the state. Fifteen years ago, the State made the decision to require the pensions systems to move away from a pay-as-you-go funding to a fully funded system. Currently most of the 106 systems under PERAC are at least fifty percent funded and several are one hundred percent funded.

There are several reasons why we do not want to be part of the Social Security System:
1) Our system is solvent and will soon be fully funded. 2) Our benefits are much better than those under Social Security. 3) We made all the right and tough decisions here in Massachusetts, and we do not want to be in a system that is going bankrupt, according to many, in the next thirty-four years. 4) If forced to join the Social Security System, it will cost the public employers and employees in Massachusetts approximately five hundred million dollars per year. If we have to appropriate that extra money for Social Security coverage, obviously we will have to cut other programs under our jurisdiction. 5) We do not want to be looked at as a “cash cow” in order to help pay the current Social Security
benefits to retirees. 6) Besides, the extra revenues would extend the Social Security System solvency for only two extra years. Finally, keep in mind that you may increase your revenues initially by having us in the Social Security System, but when the “new” Social Security participants retire, it will cost the Social Security System a lot more in the end.

Let us look for real long-term solutions to this Social Security System instead of the piecemeal approach.

Thank you for the opportunity to express my views.

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Honorary Chairman President

SAVING SOCIAL SECURITY FOR FUTURE GENERATIONS
IT’S SAFE FOR TODAY’S SENIORS

STATEMENT OF JAMES L. MARTIN, PRESIDENT OF THE 60 PLUS ASSOCIATION,
FOR THE WHITE HOUSE CONFERENCE ON SOCIAL SECURITY, DECEMBER 8-9,1998

The 60 Plus Association, a nonpartisan senior citizens advocacy group, commends the President’s year-long efforts to highlight Social Security reform, and today’s White House Conference on Social Security is part of his plan. 60 Plus is pleased to join these efforts to save Social Security, and we look forward to the President’s particular plan to strengthen and save the system for future generations.

We seniors know the system is safe for us. But the 75 million baby boomers and the millions of 20 and 30 year olds, the Generation Xers, wait literally with bated breaths for the President’s plan to save and strengthen Social Security. The importance of the President’s plan cannot be over-emphasized, because while responsible Republicans and Democrats offer positive proposals to save Social Security, clearly the President’s leadership will be needed before we can arrive at a final solution.

As the Commissioner of Social Security, Kenneth Apfel, said in a major address before the National Press Club last week, we must stop throwing “political hand grenades” on Social Security and work together with common purpose and determination. We agree.

We have a window of opportunity early in the 106th Congress to put Social Security on a strong footing for future generations. The system is like a time bomb, ready to explode. Surely, we must put partisan politics aside. We must act in a nonpartisan manner.

Why did a seniors organization such as the 60 Plus Association get involved in this matter? It would be easy for us to take an ostrich-like approach and hide our heads in the sand, ignoring the issue. Yet, we are not just “greedy old geezers” with a “gimme, gimme, gimme” mentality, as we’re wrongly portrayed. We are genuinely concerned with the future of the program and the well-being of all our citizens, not only our current seniors but those who will become seniors one day in the future.

The group I represent is called 60 Plus and I’m 60 plus in age and I still rely on my favorite senior for advice and she’s 80 plus--my mom, my sainted mom if you will, Mary L. Martin, who still works part-time. She notes that seniors most valuable assets are not just their social security, their retirement income or pensions, though these are high on their list, but it’s their children, their grandchildren, and their great grandchildren. She adds that while Social Security is safe for seniors, it needs to be protected so it is there for her other assets, her children and grandchildren, future retirees.

We believe that the best approach for saving the system is adopting the commonsense approach of privatizing or, as I prefer to call it, “personalizing” Social Security, a description borrowed from Sen. Bob Kerrey (D-NE), a leading expert on Social Security reform. This approach, despite the cry of the status quo seekers, is not going to ruin Social Security but will, I truly believe, save it.
We advocate taking part of the payroll tax, paid by employer and employee (except for the self-employed who bear the entire burden) and investing these funds in personal retirement accounts (PRAs). These accounts will be economically productive and enable workers to receive much more than the meager 1 or 2 percent return they can now expect to receive from Social Security. The returns are likely to be 2 or 3 times larger, at a minimum.

We have the example of the nation of Chile which had a Social Security system facing insolvency. A reform was adopted by Dr. Jose Pinera in 1981 and we have had 15 years to witness the success of that program--safe and secure retirement for workers, better returns on money invested for retirement, and a system contributing to the nation’s economic growth because of the money invested in the stock market. There are regulations so that a safety net is provided and only prudent investments are allowed by the government-regulated firms.

Chile is not alone. More than half a dozen nations have followed suit in Latin America. Others, such as Australia, the United Kingdom, and, even Communist China, have devised a method for personal retirement accounts. The United States needs to board this train before it leaves the station.

Seniors will back reform. We polled our seniors and found that by a 3 to 1 margin they favored a form of personalization. We then commissioned a national polling firm to conduct a survey beyond our membership and its findings confirmed that seniors back “personalization”.

It has been too easy for politicians to demagogue this issue. We need a nonpartisan cooperative effort for real meaningful and lasting reform--and the President must lead that effort.

The 60 Plus Association urges: While it’s safe for today’s seniors, we must save Social Security for future generations. Debate It, Don’t Demagogue It! Let us move toward personal retirement accounts (PRAs) so individuals, like those workers in Chile, will have their own passport of savings toward retirement and will enjoy the fruits of a growing economy reform.

In conclusion, Commissioner Apfel, in his address before the National Press Club, reminded us to work together with common purpose and determination, that just as lightning makes no sound until it strikes, we should recognize that there are rumblings on the horizon and we must act now to make the changes to keep Social Security strong into the 21st century.

Commissioner Apfel also quoted Senator Daniel Patrick Moynihan (D-NY) as reminding us that if we leave Social Security unchanged, that in 30 years time Social Security as we have known it since 1935 will have vanished. We need to reflect back on the origins of Social Security, when President Franklin D. Roosevelt signed into law the Social Security Act on August 14, 1935. The 60 Plus Association is the first seniors organization to urge personal retirement accounts (PRAs) in keeping with the original intent of Social Security to help seniors out of poverty.

On May 2, 1997, the FDR Memorial was dedicated in Washington, D.C. What more lasting commemoration to FDR can we embrace than the adoption of personal retirement accounts (PRAs) which will save Social Security for a new age, a new era, and a new generation.
WHITE HOUSE CONFERENCE ON SOCIAL SECURITY
STATEMENT

More than three years ago at the 1995 White House Conference on Aging, the resolution receiving the most votes from the delegates was entitled “Keeping Social Security sound, now and for the future.” This resolution, one of 50 adopted by the 2,259 bi-partisan delegates previewed many of the issues that are now front and center in the debate on Social Security and its future. It called for the reaffirmation of Social Security as a social insurance program, it called for an ongoing national education program to provide the public especially the younger generations with accurate information on Social Security and its future. Above all, the resolution called for exactly what the President has embarked on, a campaign to put all options for Social Security’s future on the table for a thorough discussion and not in a panic environment.

President Clinton, in calling the 1995 White House Conference on Aging, stressed that aging needed to be viewed in the context of a process that affects all generations and that aging policy decisions must be intergenerational. Decisions made about the future of Social Security have to take into account their impact on future generations. Now, three years later, a White House Conference on Social Security is convened to do just that.

Within the past year, a new organization was established called the Boomer Agenda. It is the first bi-partisan political action and issue advocacy group created by boomers for boomers and their families. The Boomer Agenda is currently conducting a national survey of boomers to determine what their top concerns are. The future of Social Security has consistently ranked as the top concern from the preliminary results received to date. It is important that this White House conference and all subsequent activities undertaken by the Administration and the Congress take into account the concerns and views of boomers. The reality is that all boomers will reach age 65 by the time that Social Security faces the most severe crisis - its inability to pay full benefits. As various approaches are presented, their impact on boomers must be evaluated or we will not achieve the critical generational equity so important for real Social Security reform.

In addition to the need for generational fairness, Social Security reform must also be far more gender sensitive. Women, especially older women, have encountered years of discrimination at the hands of Social Security. That must end. Further, any Social Security reform for today or tomorrow must have a strong safety net of guaranteed benefits for the very poor, for a foundation before anything else. The reality of today and tomorrow is for millions of Americans, Social Security is their only source of income. They will not be indulging in the speculative world of privatization but they must be protected from its risks.
As the President has stated, each year real Social Security reform is delayed, the more expensive it gets for the individual and the nation. We need to approach this challenge neither from a state of panic nor a state of complacency. The final Congress of the 20th Century working with the last President of the 20th Century should commit to the preservation and strengthening of Social Security, the greatest social program of the 20th century so it can continue.

Submitted by:
Robert B. Blancato
Executive Director, 1995 White House Conference on Aging
Founder, Boomer Agenda

December 3, 1998
Any debate on the future of Social Security requires the counsel of those most closely involved in retirement policy -- the administrators and trustees of this Nation’s public retirement systems. Accordingly, as the Executive Director of the Teachers’ Retirement System, City of New York, and President of the National Council on Teacher Retirement, I am pleased that I have the opportunity to take part in the Conference. These remarks will summarize NCTR’s views on Social Security reform.

NCTR had its beginnings in 1924; it affiliated with the National Education Association in 1937; and became an independent association in 1971. As such, it is one of the oldest continuously operating organizations devoted to retirement issues. The organization is composed of 73 retirement systems that serve over 13 million public school teachers and other state and local government employees. The systems provide retirement, disability, and other benefits. These benefits are funded through contributions by the state or local government, the employees themselves, and investment earnings.

The retirement systems that belong to NCTR are governed by boards of trustees that are made up of employees, retirees, employers, and members of the public. These board members are fiduciaries who are charged with overseeing the administration of the retirement system for the exclusive benefit of plan participants. They also prudently invest the assets in the systems’ funds, which are held in trust and therefore separate from the general funds of the sponsoring state or local government. Collectively, NCTR members hold $1.1 trillion in assets. NCTR members are a testament that governmental pension funds can be successfully managed and prudently invested without interference by the sponsoring governmental entity.

NCTR recognizes that Social Security has successfully provided basic retirement and other benefits to Americans since the 1930’s. It has raised many older Americans out of poverty and allowed them to spend their retirement years in dignity and, in fact, is the primary source of retirement income for many senior citizens in this country.

Because of the impending retirement of the 77 million baby boomers, Social Security’s financing is on a precarious basis. Accordingly, NCTR calls upon the President and Congress to take action that will ensure the long-term solvency of the Social Security Trust Fund by maintaining the economic security of current and future Social Security beneficiaries. Moreover, such action must not impair in any way the guarantee of an inflation-adjusted retirement income.

In meeting these goals, policy makers must not make changes that would weaken existing retirement programs. I am specifically referring to proposals that mandate Social Security coverage of newly hired employees of states and localities whose employees do not now
participate in the Social Security System.

Under the mandatory coverage proposals, the affected employer and employee would each pay the 6.2% into the Social Security Old Age, Survivor, and Disability Insurance fund. This amount would be in addition to the contributions already made by both the employer and the employee into the applicable governmental retirement system. Proponents of mandatory coverage argue that it provides 10% of the revenue needed to bring system into financial balance. What they fail to recognize is the tremendous cost and dislocation that affected state and local government employees and their employers would face.

By way of background, the Social Security act signed into law by President Franklin Delano Roosevelt on August 5, 1935 did not include state and local government employees. Concern existed whether the federal government had the constitutional power to require states and localities to pay the Social Security tax. By the 1950's, many states and localities were interested in voluntarily affiliating with the Social Security System. Accordingly, Congress approved so-called “Section 218 Agreements,” under which states and localities may participate in the system. Many jurisdictions availed themselves of this opportunity, including most of the retirement systems in both the State and City of New York.

Approximately four million state and local government employees are not currently covered by Social Security. Most affected would be police and fire fighters of whom 75% are not covered and public school teachers of whom 40% do not participate. When fully phased in, mandatory coverage would cost states and localities $8 billion a year and affected employees, an equal amount, totaling $16 billion.

It is unrealistic to assume that affected employers and employees can readily pay the additional 12.4% into Social Security. A second tier of benefits would have to be added to existing retirement systems for the new employees. The new tier would provide lower benefits than those for employees in the existing benefit structure. With part of the money previously available to fund the retirement system now paid into Social Security, the reduced level of funding may not be sufficient to provide both 1) adequate benefits in combination with Social Security benefits and 2) adequate financing of the retirement system’s unfunded actuarial accrued liability. In addition, a lower contribution rate for new employees into the state or local government retirement system would also decrease the rate of growth in the trust fund and cause a decline in the amount of investment return.

In summary, as the debate on Social Security reform progresses, NCTR urges the President and Congress to make changes that maintain the economic security of current and future Social Security beneficiaries, while not undermining existing retirement programs of states and localities. Again, thank you for the opportunity to participate in the Conference.

For more information, contact Mr. Miller at 212-386-5203 or Cynthia L. Moore, Washington Counsel, National Council on Teacher Retirement 703-243-3494.
Returns and Administration Costs under Alternative Social Security Reforms

Olivia S. Mitchell

It is important to be clear about three dimensions of choice in the discussion over US social security reform. The **first** dimension pertains to finding: **prefunding** social security requires increasing taxes or cutting benefits to shrink the system’s current $9 trillion in unfunded promises (amounting to a social security debt of $60,000 per US worker). The **second** dimension involves investment **portfolios**: **diversifying** social security involves investing all or part of the retirement system’s assets — totaling 1.5 years of benefit payments — in a broad range of investments including corporate stocks and bonds. (Currently, all social security funds are invested in Treasury bills.) And the **third** dimension pertains to **systemtype**. One could remain with the current national defined-benefit system, or one could convert to individual defined-contribution accounts. All reform plans pick points along these three dimensions: for instance, the recent Social Security Advisory Council put forth two plans (the Personal Security Account and the Individual Account) requiring funded defined-contribution individual accounts with diversified assets, while the Maintain Benefits plan kept the current federally-held defined-benefit system but raised **prefunding** along with Trust Fund investment in equities.

The issues now polarizing the US Social Security reform debate can be seen in the light of these choices that must be made, regarding rates of return and administration costs under a reformed system. As we show, these issues are more complex than has been recognized to date.

**Investment Returns in a Diversified System**

Some who favor diversification of social security assets offer as supporting evidence the high stock market returns of the last 20 years, and they conclude that Baby Boomers and their children could do better by investing in stocks than by remaining under the current system. But the argument that workers could earn a higher “rate of return” from investing their payroll taxes in the stock market is false for two reasons. First, returns on stocks vary more than bond returns, making investors demand a risk premium to hold these more uncertain assets. Proper risk adjustment of stock returns would render these more similar to returns on less risky assets. Second, today’s workers have inherited $9 trillion in unfunded social security promises, as noted above. If this debt is to be honored, some 3% of current workers’ pay would have to be allocated to cover retirees’ benefits — leaving only three-quarters of the social security payroll tax to be invested in the stock market. (In fact, the potential amount is even less than that since social security disability insurance benefits exceed earmarked payroll taxes as well). Evidently, the “transition cost” of old unfunded promises undermines one of the apparent advantages of

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allowing system diversification, whether it is through individual or government-managed accounts.

Despite this caveat, important benefits would flow from prefunding individual social security accounts that can be invested in a diversified set of assets. Specifically, about half of the US population holds no stock in its retirement portfolio. Many of these people would be better off from increased retirement saving in diversified assets, and individual accounts would help achieve this. Some gains might result if the federal government held the assets in the Trust Fund, but many have deep concerns about the government “picking stocks” and worry that the Trust Fund monies would be spent rather than saved.

**Administrative Expenses of an Individual Account System**

Even among those who favor funded, diversified, social security accounts, people disagree about how these accounts should be managed. If the federal government invested the money centrally via a pooled Trust Fund, the additional administrative costs of money management would be modest — probably under 10 basis points per year (a basis point is one hundredth of a percent). These would be incurred on top of current social security administrative costs of about $14 per participant per year. If individual accounts are mandated instead, additional administrative costs might come to 10-50 basis points per year — on the lower end for accounts receiving contributions worth 5% of payroll, and on the higher end for accounts receiving only 2% of payroll per year. Some analysts restate these annual charges over the participant’s worklife as equivalent to a fraction of the account’s ultimate asset value, and they arrive at numbers ranging from 1% to 20% of the final account depending on the holding period, the rate of return, and the size of the account.

It is evident, therefore, that participants in an individual account plan must devote substantial attention to how administrative charges can affect retirement saving. In exchange for these fees, individual account participants would have the opportunity to choose their fund managers and investment portfolios, and people would reap the reward from saving and managing their own accounts. These options are unavailable under a national defined-benefit approach. The US can learn from other nations that have preceded us in moving to individual retirement saving accounts, including several sister nations in the Americas. The US economy would probably do better on administrative costs because of our larger size, our more sophisticated taxation system, our technologically advanced business and labor environment, and our more efficient and transparent capital market. In any event, additional regulatory structures would be required.

Drawing these distinctions is important since they lead to several conclusions about social security reform proposals offered in the US context:

- Any reform plan boosting prefunding requires additional taxes and/or lower benefits.
- Any reform permitting asset diversification into stocks will involve additional risk.
- Any prefunded system will require regulation to effectively resist political interference.
- An individual account system will cost more to administer but will offer additional services.

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SAVING SOCIAL SECURITY FIRST: 
THE PERSONAL SECURITY ACCOUNT OPTION

Stephen Moore

President Clinton is to be commended for convening the bipartisan summit on saving Social Security. One issue that all sides should be able to agree is that we have to act now to solve the $5 to $10 trillion funding shortfall in the Social Security system. If we wait 5 or 10 years the financing crisis will be right upon us, and our range of options to save the system will be far more limited. We can see the Titanic headed for the iceberg, we need to start turning the ship around immediately.

In April of 1998 during the first town hall meeting on Social Security convened by the White House, President Clinton declared:

The Social Security system must remain universal, fair, and must deal with the problems of the disabled and the poor. If you do all that, could you construct some system which also made allowance for private accounts? I think you could, yes.

I think he is right. For the past 20 years the Cato Institute has endorsed transforming Social Security from a pay-as-you-go system, to a fully financed, individually invested program. In other words, American workers should be permitted to fully and immediately invest their Social Security payroll taxes (12 percent of their paycheck) into Personal Security Accounts (PSAs). There are 3 critical safety features to the PSA plan that I believe would satisfy the President’s concerns:

1) Every American currently receiving (or about to receive) Social Security benefits will be guaranteed that his or her payments will not be cut. Seniors should be held harmless to the change.

2) All American workers will be given the option of staying in the traditional Social Security system or investing their money in a PSA that is controlled and owned by the individual worker.

3) Every worker, whether they stay in Social Security or choose a PSA, will be guaranteed a minimum retirement benefit when they retire. In other words, there will be a safety net feature to the program.
Why should American workers and politicians favor converting Social Security to a system of PSAs? Because it offers workers a better deal. Even if workers were required to invest in non-risky investments, the rate of return on their money and their subsequent retirement income would be substantially higher than if it remained in the Social Security system. This statement is true whether the worker is black or white, man or woman, rich or poor, married or single. A median income worker born in 1970 will receive a Social Security benefit of $1,429 (assuming benefits are not cut), but with a 10 percent PSA invested in 40% bonds and 60% stocks the worker would receive a monthly benefit of $2,654. If the entire 12 percent payroll tax were put in a PSA the benefit would exceed $3,000 per month.

The general rule of thumb is that a typical worker would have a benefit twice as high under PSAs than Social Security. This analysis reasonably assumes that over the next forty years the return in financial markets will be comparable to the average rate of return from 1926-96. Americans who wish to assess how they personally would fare under a PSA system should try the Cato Institute’s Social Security calculator on our web page: www.socialsecurity.org.

It is important to emphasize that virtually all of the Social Security “reforms” proposed by opponents of PSAs would simply lower the already poor rate of return for young Americans. In other words, any “reform” option that raises the payroll tax rate or the payroll tax income threshold, that lowers future benefits, or that raises the retirement age, only worsens the rate of return for today’s worker and future generations. These options should therefore be rejected. We talk a lot about “fairness” in Washington. If fairness is to be one of our guiding principles in the search for a Social Security solution, we should not force our children to pay more in or get less out of a system that is already severely inequitable to them.

How can we finance the transition from pay-as-you-go financing to a fully funded PSA system? First, we should dedicate every penny of the current Social Security surplus to helping finance PSA's while still paying benefits to seniors. Over the next 10 years this surplus will amount to nearly $1 trillion. Second, we should examine other areas of the federal budget that could be reduced and dedicate the savings to helping finance PSAs. We at Cato have identified almost $100 billion a year in corporate welfare. Cut these Fortune 500 subsidies and use the savings to finance PSAs. Finally, the federal government should issue 50 year liberty bonds--taking advantage of the current low long term interest rates--to fund the remaining transition to PSAs. This reasonably spreads the cost of the transition to a new Social Security retirement system across future generations. This seems to be an equitable solution, since future generations will be the primary beneficiaries of a fully funded, high rate of return, PSA system.

*Stephen Moore is director of fiscal policy studies at the Cato Institute.*
The best way to assure all Americans an adequate basic retirement income is to maintain the current defined benefit structure and not to move toward a system of defined contribution accounts. Let me briefly summarize the reasoning behind that conclusion.

I. Social Security is not facing a crisis. The projected increase in Social Security spending due to the aging of the population is neither enormous nor unprecedented. The cost of the program is projected to rise by 2 percent of GDP. Budget changes equal to 2 percent of GDP are not uncommon; defense spending increased by 5 percent of GDP at the start of the cold war and declined by 2 percent between 1991 and 1998. The financing situation does not require radical change.

II. The desire to increase national saving and broaden investment options for workers--changes that have been used to justify individual accounts--can be achieved more effectively within the structure of the current program.

- The federal government can accumulate reserves. The non-Social-Security portion of the budget is headed for balance in 2002. We can keep it there and build up reserves in the Social Security trust funds. The states do it for their pension funds; the federal government should be able to do it for its major retirement system.

- Broadening Social Security’s investment options to include stocks is feasible. We know how to prevent interference in private sector activity: set up an independent investment board, invest in a broad index, and delegate voting rights to fund managers.

III. The economics are clear: Social Security’s defined benefit plan is better than individual accounts for providing Americans with their basic retirement pension.

- Because Social Security is a defined benefit plan, it can spread risks across the population and over generations. This means that individual retirees would not risk large losses in the stock market just as they approach retirement. The risks would not disappear, but gains and losses could be averaged over time and among the entire population.

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*The author served as a Member of President Clinton’s Council of Economic Advisers and Assistant Secretary of the Treasury for Economic Policy.
• Pooling investments in the Social Security trust funds also keeps transaction costs low, ensuring higher net returns than individual accounts. Administrative costs for individual accounts are likely to amount to a 20-percent cut in benefits. Data from the U.K. and Chile, countries that have adopted individual accounts, suggest that the costs could be even higher. Annuitzing individual accumulations reduces benefits by another 10 percent.

• Social Security also avoids the pressure for individuals to gain early access to their accounts, leaving retirees with inadequate retirement income. This risk is very real; individuals already have access to funds in IRAs and 401(k) plans.

• Social Security assures that accumulated funds are transformed into inflation-indexed annuities so that retirees do not outlive their retirement resources. Private annuities are over-priced for the average person, and Inflation-adjusted annuities are not available in the private sector.

• Social Security provides full benefits for disabled workers who would not have time to build up adequate reserves under a system of individual accounts. Disability benefits would be cut under all existing plans for individual accounts.

• Social Security protects women. It provides spouse’s and widow’s benefits; it automatically provides inflation-adjusted annuities (women live longer than men), and it protects divorcees (after ten years of marriage). Private accounts contain none of these protections.

• Finally, Social Security protects those with a lifetime of low earnings by replacing a greater percentage of earnings for low earners than for high earners. This redistributive component would be lost to the extent that payroll taxes were diverted toward individual accounts.

IV. There is no reason to move towards a defined contribution system; much of the projected shortfall can be eliminated with good policy changes.

• For example, extending coverage to new state and local workers, slightly increasing the maximum taxable earnings base, and reflecting BLS corrections to the CPI in the COLA are all consistent with the goals of the program.

• Broadening the investment options for the trust funds to include stocks will increase the return on fund reserves and close the remaining financing gap.

V. The argument against individual accounts applies only to the basic retirement income. On top of a fully financed Social Security system that preserves today’s promises, voluntary supplemental individual accounts administered by Social Security are a good idea. They would encourage additional saving and keep administrative costs to a minimum.
STATEMENT AT WHITE HOUSE CONFERENCE ON SOCIAL SECURITY

BY ROBERT J. MYERS*

In order to be appropriate and meaningful, any necessary reform of the Social Security program should recognize the importance of two elements--its basic purpose and its current and long-range financial status.

Nature of the Social Security Program

From the inception of the Social Security program in 1935, it has always been a social insurance system designed as an income-maintenance plan in the event that certain risks occur -- currently, age or disability retirement and death of the worker (either before or after retirement). Conversely, it was not intended to be an investment plan, under which every participant is supposed to receive the same investment rate of return.

Rather, the Social Security program is a mixture of individual equity and social adequacy, with emphasis on the latter. For example, larger benefits relative to contributions are paid in some cases than in others -- e.g. (1) workers near retirement age at the start of the program, (2) low-earnings workers, and (3) workers with dependents.

Public education is based on social adequacy principles, rather than individual equity ones -- even more so than is the Social Security program. Thus, two families with the same number and ages of children receive the same education benefits, and yet the family with a mansion pays much more real estate school taxes (i.e., a lower rate of return) than does the one with a modest home. Similarly, a family which never has children receives a very poor “rate of return” on its school taxes (unless one takes a broader view as to what is good for the nation).

Current Financial Status of Social Security Program

From a short-range cash-flow standpoint, the Social Security program is in excellent condition. At the beginning of 1998, the trust-fund balance was $656 billion, an increase in the past 12 months of $89 billion. It is likely that, in the next decade, the annual excesses of income over outgo will increase to a level of about $150 billion. Thereafter, however, according to the intermediate estimate in the 1998 Trustees Report, such excesses will become smaller, and after a decade will cease to exist (and, in fact, will turn negative). As a result, the trust-fund balance will decrease and will become exhausted in 2032.
A good measure of the long-run financial status of the Social Security program is the long-range actuarial balance. This element, expressed as a percentage of taxable payroll, if negative, indicates the increase in the combined employer-employee tax rate which would be needed immediately if the program is to be fully financed over the 75-year valuation period. According to the intermediate estimate, the long-range actuarial balance is -2.2% of taxable payroll. On the other hand, the low-cost estimate shows a small positive balance, while the high-cost estimate shows a much larger negative balance.

The conclusion to be drawn is that a significant, but not overwhelming, long-range financing problem very likely exists. This can be solved in numerous ways within the existing structure of the program. However, solving the problem by the simple, not too painful, method of increasing the combined employer-employee tax rate by 2.2% is not a complete solution, because insufficient financing would be present after the end of the 75-year valuation period.

What would happen if the assumptions of the intermediate estimate were exactly fulfilled, and the combined employer-employee tax rate were increased by 2.2%, is that huge fund balances would be built up in the next few decades and thereafter drawn down. So, at the end of the 75-year valuation period, the fund balance would be only one year’s outgo, and a higher tax rate (by about 4%) would be needed thereafter. This would hardly be a reasonable way to solve the problem.

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