NEED TO KNOW

AMERICANS FOR PROSPERITY FOUNDATION

SOCIAL SECURITY PART II: PERSONAL SAVINGS ACCOUNTS

AFPF's Need to Know: Social Security Part I explained how Social Security is not only headed for fiscal disaster, but it is also a bad deal for workers in its current form. Unless the program is restructured, this bad deal is going to get even worse. The program's $18 trillion in unfunded liabilities will have to be paid for with massive payroll tax increases, dramatic benefit cuts, or more government borrowing – a drag on the American economy, a disappointment to future retirees, or a bigger debt burden left for future generations.

PERSONAL SAVINGS ACCOUNTS FOR SOCIAL SECURITY

Thankfully, there is a better way. We could empower workers with a choice: stay with the tax-and-benefit system of Social Security as it is now, or save and invest your same payroll tax contributions through a personal savings account. Instead of seeing their hard-earned dollars funneled through Washington to pay for current retiree's benefits, workers would truly own and control the accumulated funds and could invest them with a wide variety of investment funds offering different mixes of stocks and bonds and different levels of risk and reward. There are a number of benefits to this:

• *Reduced Spending*: With workers financing their own retirement instead of relying upon government0provided benefits, this would dramatically reduce Social Security's enormous burden that currently consumes over 20 percent of the federal budget.

• *Reduced Taxes*: Eventually the entire employee and employer portions of the payroll tax (a combined 12-plus percent tax on the first $110,100 in wages) could be fully phased out and replaced with personal savings and investment.

• *Reduced Debt*: A number of proposals for adopting Social Security personal savings accounts are actuarially sound and would fully eliminate the program's current unfunded liability of nearly $18 trillion over time.

• *Ownership Instead of Tax-and-Redistribution*: Unlike with Social Security now, workers would own the funds they accumulate in their accounts. This would give them the freedom to choose their own retirement age instead of letting the government dictate it for them. They could also pass along their lifetime of savings to their children and grandchildren when they die. With everyone in society having a stake in a strong private-sector economy, it would also help dissolve the current divide between those with personal assets and those who depend on government.

QUICK FACTS

- Some have argued that the financial crisis proves optional personal accounts are a bad idea. Not so. If a typical couple retired at the bottom of the market following the 2008 financial crisis, and even if they had pursued the riskiest of investment strategies with their personal accounts, they would still see retirement benefits that are 75 percent more generous than what the current Social Security system promises (1).

NOTABLE & QUOTABLE

"Given the [Social Security] program's looming financial crisis, benefit cutbacks are increasingly likely ... Indeed, Congress has already arbitrarily reduced Social Security benefits of some groups of workers. Moreover, because Social Security benefits are not a worker's property, they are not inheritable. In contrast, a privatized Social Security system, based on individual accounts, would provide workers with the benefits and the safeguards of true ownership."

- **Charles E. Rounds, Jr.**, Suffolk University Law Professor

Perhaps most importantly, by harnessing the power of higher investment returns in private capital markets, personal savings accounts offer more generous retirement benefits than the current Social Security system promises (let alone what it will actually pay in the future). Studies have shown that this is still true even after the stock market declines seen during the financial crisis (2).

By harnessing the power of higher investment returns in private capital markets, personal savings accounts offer more generous benefits than the current Social Security system.

Of course, there are risks. Investments in stocks and bonds have no guarantee and can incur losses. But a central pillar of all personal account proposals is an opt-in requirement. Workers are individually free to choose to take risks and invest in capital markets with a personal savings account, but if they think it is too risky they also have the option to stay with the current system. The key point is that workers are given the freedom to choose how their payroll tax contributions are saved and spent, and this freedom must be at the core of any effort to save Social Security.

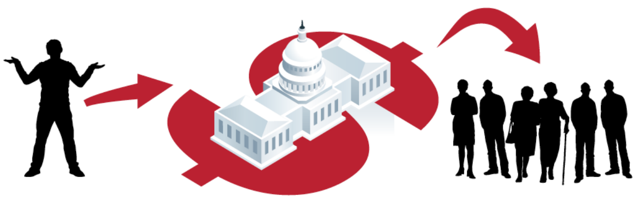
Most personal account systems also contain a guaranteed floor on returns, meaning that if the return on a particular personal account ever falls below what the government pays through traditional Social Security the individual would receive at least those levels of benefits. Thankfully, this won't actually cost the system any money because private accounts have always done better than the public system. But it's a good reassurance for participants.

PROVEN TO WORK

Chile adopted a personal accounts option for their workers in 1981, a reform that has been quite successful. Within 20 years, a full 94 percent of Chilean workers had opted in to the new system, probably because it paid retirement benefits that were, on average, 50-100 percent higher than the old system's benefits. Removing this spending burden helped lower Chile's budget deficits, and the country's national debt as a percent of GDP is now one of the lowest in the world (3).

You don't have to go to another continent to find successful examples – there's one right here in the U.S. The same year that Chile launched their reforms, public employees in Galveston County, Texas voted to opt out of the Social Security system and instead adopted a similar plan with similar success. As of 2005, average annual rates of return have been 6.5 percent in the Galveston program, much higher than what traditional Social Security promises (4). Two other Texas counties followed suit the year after and more was sure to follow. However, not wanting to lose more and more contributors to Social Security's payroll tax pool, the federal government banned these types of opt-outs in 1983.

Social Security's Current Structure



Workers see payroll taxes take a big chunk out of every paycheck. Those funds are then funneled through Washington to pay for current retirees' benefits. It's a pay-as-you-go system that for decades has counted on fewer and fewer workers to pay for each retiree.

Social Security with Personal Savings Accounts

Workers have the choice to put all (or a portion) of those same payroll taxes into a savings account that they own and control, allowing them to accumulate wealth over the years and fund their own retirement.

Endnotes:

1. William Shipman & Peter Ferrara, Private Social Security Accounts: Still a Good Idea, WALL STREET JOURNAL (October 27, 2010) (online at http://www.cato.org/pub_display.php?pub_id=12514).
2. Michael Tanner, Still a Better Deal: Private Investment vs. Social Security, THE CATO INSTITUTE, Policy Analysis No. 692 (February 13, 2012) (online at http://www.cato.org/pub_display.php?pub_id=14088).
3. TRANSFORMAMERICAS, Social Security (Pension) Archives (online at http://www.transformamericas.org/?cat=100).
4. Ray Holbrook and Alcestis "Cooky" Oberg, Galveston County: A Model for Social Security Reform, NATIONAL CENTER FOR POLICY ANALYSIS (April 26, 2005) (online at http://www.ncpa.org/pub/ba514).

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