



Social Security Reform

Why Personal Accounts? Why Now?

Why does Social Security need reform?

Social Security is a pay-as-you-go program, which means that today's workers pay the benefits for today's retirees through payroll taxes paid by workers and their employers. The current combined payroll tax represents an astonishing 12.4 percent of the average workers' salary, meaning that 80 percent of Americans already pay more in Social Security taxes than in U.S. income taxes. When Social Security was created, there were 40 workers to every retiree, but today there are only 3 workers per retiree and the ratio will decline to 2-to-1 as the baby boomers retire. Despite over 20 tax increases in the program's history, Social Security will run into the red in just 12 years, when benefits paid exceed contributions into the system. Americans will face even greater tax increases and benefit cuts if Congress doesn't act soon.

What about the Social Security Trust Fund?

Congress currently spends Social Security's surplus revenues and places "special issue" government bonds into the Social Security Trust Fund. Unfortunately, these bonds are simply an accounting measure and only represent a promise by Congress to repay the Trust Fund. Unlike "public issue" U.S. Treasury bonds, Social Security bonds are not held by investors, there is no secondary market to buy and sell them, and they do not represent real assets. In 2017, when current payroll taxes can no longer fund current benefits, the Trust Fund's special issue bonds will require more tax dollars to be paid back—which is what would be done if they did not exist at all. The Trust Fund is simply a paper accounting measure; in 2017, Congress will still have to raise taxes, cut benefits, or issue actual public debt. New legislation proposes that the surplus instead be put into personal retirement accounts that each worker would own and could pass on [HR 3304 and S1302].

What are Personal Retirement Accounts?

Voluntary Personal Retirement Accounts (PRAs) let those Americans that want to invest a portion of their payroll taxes into an individual account similar to a 401(k) that workers own, control, and can even pass onto their children. Unlike the unredeemable "special issue" bonds in the Social Security Trust Fund, PRAs will contain real assets that grow with the American economy. One Social Security reform plan would actually provide a 30 percent increase over current benefits, according to Social Security administrators. The more money workers can invest in their personal account, the greater the benefits those accounts will provide when those workers retire. And while investing can be risky over short periods of time, it's reliable over an entire working life.

In fact, PRAs are already working in over 20 countries, and U.S. Federal employees already enjoy a similar system in the form of the successful Thrift Savings Plan.

What are the benefits of personal retirement accounts?

- **Higher Returns and Greater Benefits:** Even the most conservative investors would accrue substantial assets during their lifetimes through privately invested accounts, yielding far more than Social Security promises in retirement income.

- **Private Property:** Individuals would own their personal retirement accounts. Accumulated assets could be used at retirement and/or passed on to family members.
- **Creation of Wealth:** Low-wage workers would become shareholders in the U.S. economy and, through private investment and participation in the market, accumulate wealth.
- **Individual Empowerment:** Individuals would control their retirement security, and they would see their accounts grow as a result of hard work.
- **Improved Economy:** Economists believe that the overall economy will benefit from an increase in savings and investment resulting from this system.

How can we fund the transition to PRAs?

Because Americans are depending on Social Security, the cost of doing nothing is greater than the cost of creating PRAs. Social Security already contains a massive unfunded liability of \$12 trillion-- reform simply begins to acknowledge an obligation and a debt that already exists. Further, there are several sound legislative proposals that will create PRAs without raising taxes or cutting benefits for current retirees and those near retirement. However, this window is closing, and the real cost lies in doing nothing because the longer we wait, the less time PRAs will have to grow and avoid this crisis.

Wouldn't investing these taxes be risky?

A study done by the CATO Institute has shown that there has been no 20 year period where there has been a loss in the market. In fact, the 3.36% rate of return on investments in the market's worst 20 year span, between 1929-1948, is still much greater than the rate of return retirees receive currently on Social Security. And with future retirees facing a negative rate of return, the current Social Security system is much riskier than market investments. At any time, the federal government can simply raise payroll taxes or reduce benefits, which it often has in the 60 plus year history of the Social Security program. Keep in mind that Social Security as it exists promises less than a 2% return on investment for current and near term retirees, and that does not even take into account the 30% reduction in benefits or 50% tax increase that would be necessary to maintain the financial integrity of the current system.

What about the "transition cost?"

Contrary to conventional thinking, allowing workers to invest a portion of their Social Security taxes through personal retirement accounts will incur no net cost to the federal government.

The misconception that there will be new costs--i.e., "transition costs"--arises from forgetting that Social Security is already, in effect, debt-financed. Consequently: 1) Any debt sold to the public in the short term during the so-called "transition period" to pay all promised Social Security benefits simply refinances an existing liability; and 2) Refinancing Social Security's debt through personal accounts makes possible a reduction, and eventually an elimination, of Social Security's unfunded liability, which otherwise is scheduled to grow without bound.

