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## Owning Our Future: The Change Within Social Security

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Social security is the largest investment most of us will make in our entire lives, and it will likely be one of our worst. At what cost will we continue paying into a system that has repeatedly raised taxes and cut benefits since its inception? At what point will we demand that social security stop undermining the retirement security of future generations?

By Ryan Lynch

**S**ocial Security pays out more money than any other government program in the world. In 2006 alone, the Social Security Administration generated roughly \$745 billion in revenue through the combined payroll tax contributions of employers and employees, \$461 billion of which was paid out to retirees.\* Over 40 million people currently receive monthly benefit checks, with two-thirds dependent upon the checks for 50 percent or more of their annual income. Within this group, roughly 8 million retirees count Social Security benefits as their sole source of income.

This means that in addition to being a large government program, Social Security is a critical component of our economic lives. Furthermore, it is a program that many Americans hold dear to their hearts. This is due likely to the retirement dignity that Social Security offers and the spirit of intergenerational cooperation the program fosters, but it may also be due to the misguided notion that Social Security provides free money upon retirement. No matter the source of the sentiment, the historic popularity of Social Security has eroded recently, with a Gallup Poll during President Clinton's administration showing that more than half of Americans want program partici-

pation to become entirely voluntary.

Part of the reason public opinion has shifted lies in the program's design. Enacted in 1935, Social Security began with two main objectives: to link taxes paid with benefits later received, and to protect seniors against poverty. Despite these conflicting motives of self-interest and charity, the program proved more or less successful during the course of the last century. Social Security bestowed windfalls (defined as benefits greater than the combination of contributions and interest) of prodigious proportion upon early participants; and the poverty level among the elderly decreased to a current rate of about 10 percent, including a significant drop from 35 percent in 1960 to 15 percent in 1980.

This success, however, has come at a cost. The windfalls that retirees received in the past—Ida May Fuller, for example, the first recipient of monthly checks, contributed just \$24.75 in taxes and received \$22,888.92 in payments—have burdened subsequent generations with higher tax rates and lower benefits. Because Social Security simply transfers money between generations, retirees are directly dependent upon workers, who have seen the payroll tax increase from 1 percent at the program's inception to a current rate of 6.2 percent. Employers

Keeping the system solvent would require an additional 16 percent increase in workers' payroll taxes or a 13 percent decrease in benefits.

pay an additional 6.2 percent of each worker's paycheck into the system, though most economists consider this portion of the tax to be counted against worker income, too. Putting the two portions together, workers contribute a staggering 12.4 percent of overall earnings to Social Security.

Despite past tax increases and benefit cuts, the strain of retiring baby boomers means that Social Security will not be able to pay more than 75 percent of benefits beyond 2041. According to the 2007 report from the Social Security Administration's trustees, keeping the system in balance for the next 75 years would require "an immediate increase of 16 percent in payroll tax revenues or an immediate reduction in benefits of 13 percent or some combination of the two." And these changes would have to be done right now—any delay makes the tax increases, benefit cuts, or combination thereof even more punitive.

Based on the program's track record of gobbling up increasing shares of worker income and continually reducing retiree benefits, it is no surprise that many people want to reform the system. Before we think about changes to the system, though, we should re-examine the way we think about Social Security.

### Changing the Way We Think

If we are going to properly reform Social Security, we must first change the way we think about the program. Referring to Social Security as a "Ponzi scheme" or as the equivalent of "robbing Peter to pay Paul" may be of some use from time to time, but a meaningful understanding of how the program should be reformed will require tools that help us dig deeper. Here are three.

The first is a thought experiment. Imagine for a moment that there were no Social Security program, and that Congress wanted to pass retirement security legislation that would require workers to contribute a portion of each paycheck in exchange for future benefits. Would you support the bill even if you knew that only 75 percent of your benefits would be paid, and that you would receive nothing if you were to die before retirement?

It is hard to imagine that you would, and yet we continue paying into Social Security.

It would be good for all of us to occasionally take a step back and wonder, If Congress were to propose the creation of Social Security in its current financial state, would I support the bill?

The second tool is to begin looking at our contributions as investments. Social Security is the largest investment most of us will make in our entire lives, and it will likely be one of our worst. Many working women are particularly hard hit. This is because married women receive either 100 percent of their earned benefits or 50 percent of their spouse's earned benefits, whichever is larger. Women who take time off work to raise children or who make less money than their partner end up receiving half of their spouse's benefits, or the same amount as a married woman who never paid any money into Social Security.

Assuming a medium earnings level and an average life expectancy, today's younger workers can expect about a 1-2 percent rate of return on their contributions (see chart below). By comparison, the rate of return on an FDIC-insured certificate of deposit is about 5 percent. Which should be reason for us to ask: Why are we mandated to save for retirement through a system that offers a worse deal than the local bank?

A third consideration is the effect that Social Security will have on future generations. Current forecasts suggest Social Security will consume 50 percent more of the GDP in 2080 than it did in 2006, a burden that will undermine the financial security of future Americans. Provided, that is, the program lives that long. In a mere 10 years, Social Security begins running cash deficits by paying out more money in benefits than it receives in contributions. Is this the system we want to pass on to our children and grandchildren?

### Changing the System

For the last 10 years or so, the Social Security debate has focused on one point: how to include an element of investment. President Clinton explored investing So-

cial Security's surplus funds, and President George W. Bush offered a plan for voluntary personal retirement accounts, a concept that Clinton also endorsed.

The debate over investment is most certainly not over, especially because tax increases and benefit cuts are the only alternatives. This means that some sort of investment is likely in store for Social Security, though exactly what sort remains unclear.

**Personal Retirement Accounts.** One option is investment inside of the system, or personal retirement accounts. Under a system of personal accounts, workers would be able to divert some of their payroll tax contributions into an investment vehicle such as an index or life-cycle fund. Such a system would likely be modeled after the Thrift Savings Plan (TSP), a retirement savings plan for federal workers. Of the 5 funds in the TSP, the worst rate of return for the last 10 years is 5.31 percent, or about double the Social Security rate of return. These results, coupled with the fact that the Dow Jones Industrial Average has never decreased over a 40-year period, should expose claims that market risk poses too significant a threat to retirement savings as unnecessarily alarmist and historically inaccurate.

There are two ways in which personal accounts could be funded by the

payroll tax: as add-ons or as carve-outs. Add-on accounts would be financed by an increase in the payroll tax, whereas carve-out accounts would be financed using the current tax rate. There is considerable disagreement among would-be reformers as to which type of account is more deserving of support, with the carve-out crowd viewing the add-on people as too eager to compromise, and the adds-ons viewing the carve-outs as dogmatically principled.

Regardless of their differences, members of both camps generally agree that Congress should protect the surplus revenue that Social Security will generate until 2017. The current surplus is ostensibly placed into a trust fund, but that fund is raided by Congress each year to cover general expenditures. Recently proposed legislation to end the raid did not garner enough votes to pass, and with the extra revenue drying up in 10 years, it is increasingly unlikely that the surplus will be protected and saved, let alone make its way back to workers in the form of personal accounts.

**Universal Savings Accounts.** The second option for including an element of investment is for the government to match worker contributions to personal accounts outside of Social Security, often referred to as universal savings accounts. The goal of these accounts would be to

Working women are particularly hard hit, and today's young workers can expect a one to two percent rate of return on investment—a deal worse than the local bank.

OASDI Internal Rate of Return Under Payable Benefits Scenario

Year of Birth	Year Attains 65	Single Male	Single Female	One-Earner Couple	Two-Earner Couple
1920	1985	2.82	3.73	6.37	3.62
1930	1995	2.05	2.70	5.06	2.68
1937	2002	2.00	2.52	4.68	2.53
1943	2008	1.84	2.33	4.37	2.30
1949	2014	1.95	2.42	4.38	2.37
1955	2020	1.91	2.38	4.29	2.31
1964	2029	1.60	2.05	3.85	1.98
1973	2038	1.27	1.72	3.42	1.64
1985	2050	1.17	1.56	3.30	1.52
1997	2062	1.18	1.51	3.21	1.46
2004	2069	1.18	1.49	3.15	1.43

Source: Social Security Administration, March 2007

increase individual savings, but in actuality there is no compelling reason for this plan to gain entrée into the discussion about reforming Social Security. In addition to not being financed through the payroll tax, universal accounts would do nothing to change the long-term health of Social Security. As a result, this paper will suspend judgment on universal savings accounts.

**Public Policy Implications.** Americans can not afford, however, to suspend judgment on personal retirement accounts. Personal accounts have two great advantages: choice and ownership. In addition to allowing people a choice in their own retirement planning, personal accounts would enable every worker to own inheritable wealth. Politicians would no longer be able to spend Americans' retirement money on bridges to nowhere.

For these reasons and more, personal accounts have found a wide audience of advocates. Perhaps most notably, the current generation of young workers—the generation with more to gain or lose than

any other group in the debate—supports personal accounts 2-to-1.

International interest has picked up as well, with India and Mexico among the countries adding personal accounts to their retirement systems in 2007 alone. These reforms are modeled on the Chilean system, which has successfully used personal accounts as the foundation for retirement security since 1981. Even China has opened its pension surplus to equities, investing some of the public funds in American companies. These trends make it rather hard to argue against personal retirement accounts for American workers.

It is merely a matter of time until the Social Security debate heats up again, and when it does, you can expect investment to be a central component of the proposed reform. Our job will be to defend the interests of future generations by fighting for the principles of choice, ownership, and fairness within the system. Let us be ready. ■

*\*Note: Social Security is made up of Old-Age Survivors Insurance and Disability Insurance. This paper addresses only the former part in theory, but I use figures for the entire program as a result of availability and use the general name "Social Security" for the sake of simplicity.*

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Personal retirement  
account plans for  
federal workers  
generated a  
minimum rate  
of return of 5.31  
percent—about  
twice that of social  
security—over the  
past decade.

## Resources

U. S. Social Security Administration, [www.ssa.gov](http://www.ssa.gov)

Thrift Savings Plan, U. S. Federal Retirement Investment Board, [www.tsp.gov](http://www.tsp.gov)

Ferrara, Peter J. and Michael Tanner: *A New Deal for Social Security*

Light, Paul: *Still Artful Work, The Continuing Politics of Social Security Reform*

Schieber, Sylvester J. and John B. Shoven: *The Real Deal*

Shaviro, Daniel: *Making Sense of Social Security Reform*

Suggestions for further reading:

[www.SecureOurFuture.org](http://www.SecureOurFuture.org)

Buckley, Christopher: *Boomsday*

Feldstein, Martin: *Privatizing Social Security*

Tanner, Michael (ed.): *Social Security and Its Discontents*



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## About the Author

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