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Social Security Reform Proposals
USAs, Clawbacks, and Other Add-Ons

by Darcy Ann Olsen

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Faced with Social Security's impending deficits, some lawmakers have proposed supplementing the program's benefits with personal, market-based retirement accounts for all workers. Those proposals, dubbed "add-ons" because they would be added to the existing Social Security system, do not address Social Security's financial crisis. They would merely create another centralized retirement plan requiring a new funding stream.

Proposed funding sources include voluntary individual contributions, general tax revenue, and mandatory payroll tax increases. Depending on which funding mechanism is selected, the market-based retirement accounts threaten to become tax shelters for higher-wage earners, become new entitlements, or increase the payroll tax burden. Although some add-ons are designed to "shore up" Social Security by cutting its benefits by the amounts accumulated in the accounts, such plans rely on a vast infusion of government money and offer no greater retirement income for workers.

Studies show that if workers could invest what is currently taken from them in the form of Social Security payroll taxes, they would retire comfortably. Since workers already save enough to secure a comfortable retirement, it would be more sensible to let them get a better deal on their current payroll taxes by putting that money in personal accounts. Those accounts can be integrated with Social Security and therefore have the potential to eliminate Social Security's financial crisis. In addition, the accounts can ensure that all workers, not just the wealthy, can retire with financial security.

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Introduction

In his 1999 State of the Union Address, President Clinton proposed what he termed Universal Savings Accounts (USAs) as a way to improve retirement security for workers. His proposal is one of dozens that recognize that workers should have the chance to increase their private retirement savings by owning personal, market-based retirement accounts. Although most members of Congress seem to agree that workers should own personal retirement accounts, there is some disagreement about how the accounts should be funded.

For instance, President Clinton would fund new accounts through a method called an "add-on." As its name suggests, an add-on would require workers to pay an additional amount of money, supplementary to the 12. 4 percent Social Security tax, to establish new accounts. Proposed resources for add-on accounts include voluntary contributions by individuals, mandatory increases in the payroll tax, and general tax revenue. In the case of USAs, the funding source would be a combination of general tax revenue and voluntary individual contributions. In one plan proposed by two members of the 1994–96 Advisory Council on Social Security, the funding source would be a mandatory increase in the payroll tax. The common element of add-on proposals is that they require workers to contribute money above and beyond what they are currently forced to pay to Social Security.

The fundamental drawback with most add-ons is that they do not address Social Security's problems. Add-ons have no more to do with reforming Social Security than do Roth individual retirement accounts or any other private retirement plan; they would simply be one more personal retirement vehicle. If such accounts are established, Social Security's date of reckoning will not change by a day: the system will still face a $9.5 trillion unfunded liability requiring estimated benefit cuts of 30 percent or tax increases of more than 5 percentage points.[1] And depending on how they are financed, add-ons could increase the payroll tax burden, become a new entitlement, or become a tax shelter for higher-wage earners, while doing little to improve retirement security for workers. For example, if contributions were voluntary, evidence from 401(k) plans indicates that half of workers earning less than $35,000 would probably not participate. That would effectively create a tax shelter for higher-wage earners but would not improve retirement security for lower-wage workers. Some add-ons, like the one proposed by House Ways and Means Committee chairman Bill Archer (R-Tex.) and Social Security Subcommittee chairman Clay Shaw (R-Fla.), are designed to "shore up" Social Security by cutting benefits by the amounts accumulated in the accounts at retirement, but such plans rely on a vast infusion of government money and offer no greater income for workers at retirement.

A better way to fund personal accounts is to allow workers to use existing payroll taxes that are currently slated for Social Security. This method of financing personal accounts is known as a "carve out." The distinctive feature of carve-out accounts is that they do not require workers to contribute additional money to what they already pay into Social Security. Instead, such accounts would be funded by redirecting a portion of the current payroll tax to new retirement accounts. For that reason, those accounts avoid the add-on pitfalls: tax hikes, new entitlements, and de facto advantages for the wealthy. Furthermore, such accounts are clearly integrated with Social Security and therefore have the potential to eliminate Social Security's financial crisis. These accounts will increase the private savings of all workers, thereby reducing dependence on Social Security and explicitly reducing Social Security's liabilities. Carve-outs can ensure that all workers, not just the wealthy, have the opportunity to save and retire with financial security.

Universal Savings Accounts and Other Voluntary Accounts

The idea of establishing individual

accounts funded by voluntary contributions is a favorite among politicians because they can talk about the positive aspects of individual accounts—worker empowerment, personal ownership, and wealth creation—while avoiding altogether the unpleasant but central issue of Social Security reform. In the end, these plans simply call for greater contributions from working Americans but ignore Social Security's financial crisis. If Congress established voluntary accounts, Social Security's unfunded liability would not change by a penny: the program would still face a $9.5 trillion liability because the new accounts would not bring revenue into the system or reduce benefit obligations to beneficiaries. In addition, as this section illustrates, those accounts will likely do little, if anything, to improve retirement security for the low-income workers whom they are designed to benefit.

The best-known proposal for voluntary accounts is President Clinton's Universal Savings Accounts. USAs would be funded through a combination of government deposits and voluntary individual contributions. In general, workers and nonworking spouses in low- to moderate-income households would receive an automatic government contribution of $300.[2] The automatic contribution would be phased out as incomes rose—at between $20,000 and $40,000 for singles, $30,000 and $50,000 for head of household filers, and $40,000 and $80,000 for joint filers.[3] Workers could also make voluntary contributions to their accounts that would be matched progressively by government contributions. The matching contribution would be dollar-for-dollar and would be reduced to 50 percent over the same income ranges as the automatic contribution. It would then remain at 50 percent until the income level at which eligibility ends.[4] Total contributions to an account, including government and worker contributions, are capped at $1,000 per year per person.

Participation in USAs is likely to be anything but universal. Only low- to moderate-income workers would receive the automatic $300 government deposit; however, most low- to moderate-income workers would not benefit from the voluntary component and corresponding government match, because they would not be able to afford the requisite contribution. In fact, as this section documents, experience with 401(k) plans indicates that low-income workers, who most need additional retirement income, will be the least likely or able to take advantage of the voluntary (and largest) portion of USAs.

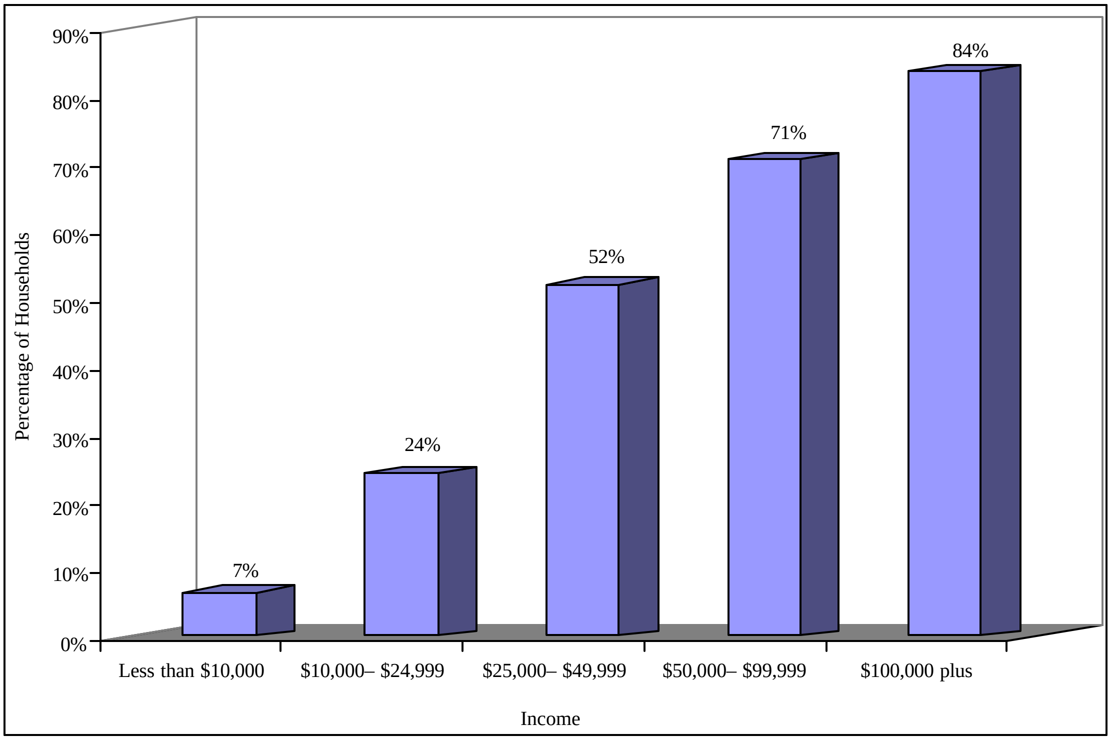
Low incomes present the most fundamental obstacle to saving. The truth is that salaries of low-income workers barely cover basic living expenses.[5] According to the 1998 Retirement Confidence Survey, conducted by the Employee Benefit Research Institute, one in three Americans is not saving for retirement. By far the most common reason given for not saving is "too many current financial responsibilities."[6] Some 40 percent of workers said they could not save even an extra $20 per week for retirement.[7] Opening accounts for workers will not change that: workers who are either unable or unwilling to save more will not begin to do so simply because the government opens an account in their name.[8]

If Congress established voluntary accounts, Social Security's unfunded liability would not change by a penny.

It is no surprise that the more one earns, the more likely one is to save for retirement. For example, only 6 percent of households with incomes of less than $10,000 have retirement accounts compared with 24 percent of households with incomes ranging from $10,000 to $24,999. Figure 1 shows the percentage of households (by income) that own retirement accounts. Similarly, the more one earns, the more likely one is to save and invest in capital markets. Figure 2 shows the percentage of households (by income) that own mutual funds and stocks.

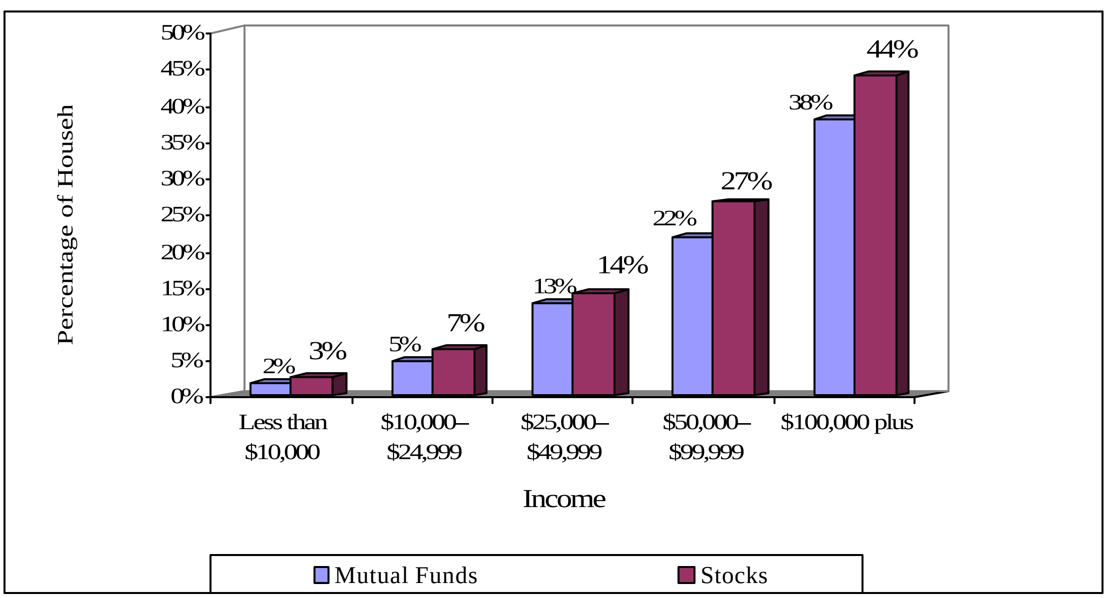
One reason there is widespread support for policies that would encourage individual retirement savings is that so few low-income households have managed to accumulate retirement assets, which makes those households dependent on Social Security for most of their retirement income. The Social Security Administration reports that 30 percent of retirees depend on Social Security for

Figure 1
Percentage of Households (by income) Holding Retirement Accounts (1995 dollars)



Source: Arthur B. Kennickell et al., "Family Finances in the U.S.: Recent Evidence from the Survey of Consumer Finances," *Federal Reserve Bulletin* 83, no. 1 (January 1997): 9.

Figure 2
Percentage of Households (by income) Holding Mutual Funds and Stocks (1995 dollars)



Source: Bureau of the Census, *Statistical Abstract of the United States: 1998* (Washington: Government Printing Office, 1998), p. 514.

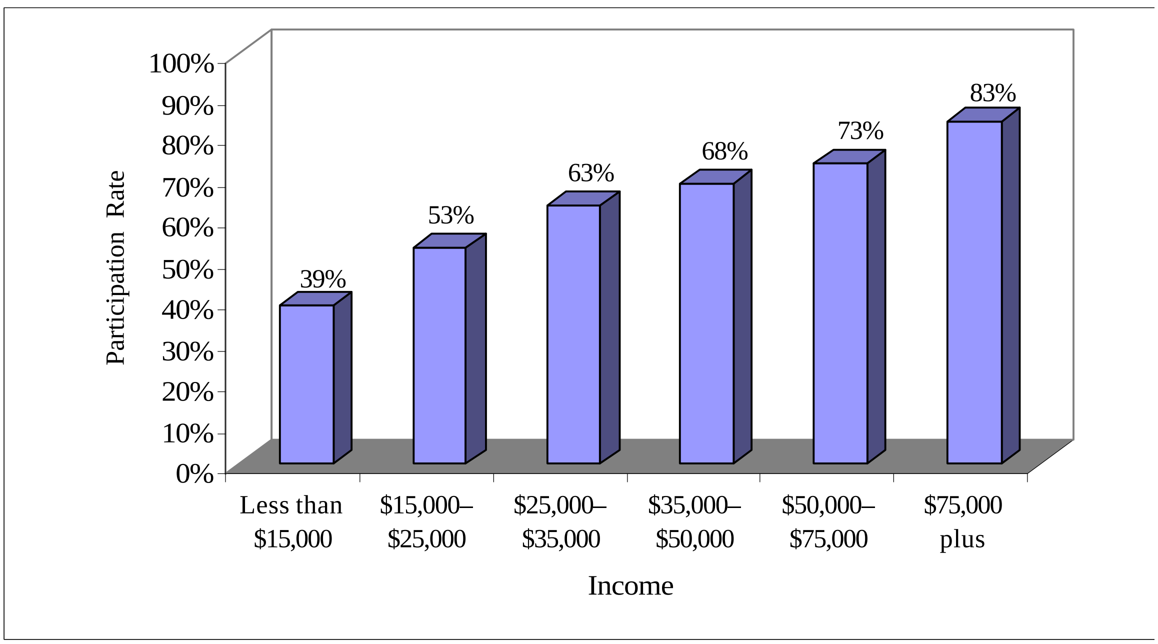
more than 90 percent of their retirement income.[9] Will USAs, as President Clinton put it, "make real retirement security universal"?[10]

To answer that question, it is instructive to examine worker participation rates in 401(k) plans in which employers match employee contributions. Research on worker participation in 401(k) plans with employer matches is relevant to the discussion of USAs because USAs would have important features of 401(k) plans. USAs would be offered through employers, and the government would match worker contributions to varying degrees. Contributions would go into market-based retirement accounts.[11] Nevertheless, 401(k) plans with matches are not a perfect analogy with USAs. For instance, several factors that influence participation rates in 401(k) plans, such as loan provisions, investment choices, and hardship withdrawal provisions, have not been examined.[12] Variation in match rates, eligibility phaseout ranges, shifts in savings, and differential tax treatment could also affect participation data. Furthermore, basing estimates of expected participation rates in USAs on participation rates in 401(k) plans with an employer match could lead to overgenerous estimates. That is because participation rates in those 401(k) plans are significantly higher than participation rates in similar savings and retirement plans such as IRAs, regular 401(k) plans, stocks, and mutual funds. On balance, however, participation in 401(k) plans is the best available model and offers a reasonable starting point for figuring out who could be expected to participate in the voluntary component of USAs and similar voluntary accounts.

Not surprising, one of the most important determinants of 401(k) participation rates is income level.[13] Figure 3 shows rates of participation by income in 401(k) plans with an employer match. Of workers offered a 401(k) plan with an employer match, 39 percent of those earning less than $15,000 annually participate, whereas 53 percent of those earning $15,000 to $25,000 participate.

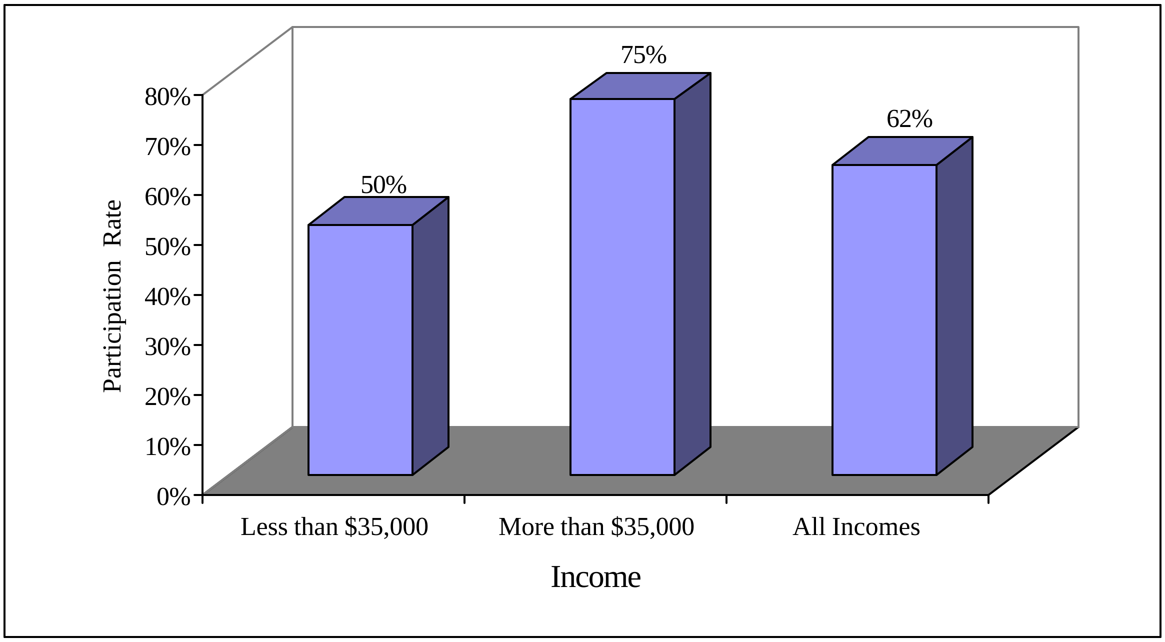
Workers who are either unable or unwilling to save more will not begin to do so simply because the government opens an account in their name.

Figure 3
Participation Rates (by household income) of Workers Offered 401(k) Plans with Employer Matches (1993 dollars)



Source: William Bassett, Michael Fleming, and Anthony Rodrigues, "How Workers Use 401(k) Plans: The Participation, Contribution, and Withdrawal Decisions," *National Tax Journal* 11, no. 2 (June 1998): 275.

Figure 4
Estimated Participation Rates (by income) of Workers in Voluntary Accounts (1993 dollars)



Source: Calculations by Carrie Lips, Social Security analyst at the Cato Institute, and author. Based on data from Bureau of the Census, *Statistical Abstract of the United States: 1998* (Washington: Government Printing Office, 1998), p. 471; and the Current Population Survey as reported in William Bassett, Michael Fleming, and Anthony Rodrigues, "How Workers Use 401(k) Plans: The Participation, Contribution, and Withdrawal Decisions," *National Tax Journal* 11, no. 2 (June 1998): 275.

Policymakers can expect that participation rates will be significantly lower among low- and moderate-income workers than among higher-income workers.

Contribution rates also vary with income, from a mean rate of 5 percent of salary for participants with incomes of less than $15,000 to more than 7 percent for participants with incomes of $50,000 or more.[14]

If 401(k) plans with matches give a reasonable indication of participation in USAs and similar accounts, policymakers can expect that participation rates will be significantly lower among low- and moderate-income workers than among higher-income workers. As Figure 4 shows, at least one of two workers earning $35,000 or less would not participate, either by choice or because of financial constraint.[15] An estimated three of four workers earning more than $35,000 would participate. Altogether an estimated 40 percent of workers would not participate—a number that hardly indicates universal participation.

Proponents of USAs point to experience with Individual Development Accounts (IDAs) in an attempt to demonstrate that low-income workers could save at rates equal to those of higher-income workers, despite the fact that most do not do so currently. That assumption is based on the theory that savings rates are driven largely by institutionally structured incentives rather than by income. Most IDAs, which were a driving force behind the proposal for USAs, are matched savings accounts designed to help low-income workers build assets for such purposes as buying a first home, education, or starting a new business.[16] IDAs and USAs share several important features. Both (1) target lower-income workers, (2) encourage participation through generous matches, (3) use institutional savings mechanisms such as the government and employers to make participation easy, and (4) provide financial education information.

According to researchers at the Center for Social Development at Washington University in St. Louis, Missouri, the first major study of IDAs was the American Dream Demonstration (ADD), initiated in 1997.[17] The study involved 13 private organizations that were selected to design, implement, and administer IDAs in their communities. Unfortunately, there is little evidence to date that either demonstrates or disproves the effectiveness of IDAs. Thus far, the median value of the closing balances in the ADD is $80 (participant savings) or $224 (participant savings, interest, and matching funds). There are no significant differences in total IDA account balances by gender, residence, educational attainment, employment status, marital status, or monthly income.[18] Those findings contrast starkly with individual retirement accounts, savings accounts, and 401(k) plans. As the researchers put it, "Standard economic theory would not predict this uniformity, especially across education, employment, and income levels." They conclude, "It is far too early in the ADD evaluation to draw conclusions, but this pattern of savings and IDA balances . . . may suggest that the IDA program itself, more than individual characteristics, may be determining amounts of savings."[19] Given that the ADD evaluation is in its earliest stages, it would be premature to draw any lessons from the results.

Although the ADD study was the first major attempt to show the effectiveness of IDAs, a few small demonstration projects have also attempted to do so. For example, Brian Grossman of the Corporation for Enterprise Development writes, "Data from the National Federation of Community Development Credit Unions (NFCDCU) proves that the poor can and do save money."[20] That remains to be seen. In fact, the NFCDCU says its data are not available to the public. Such a statement prevents researchers from verifying that claim.[21] Most other IDA programs are too new to have been studied or do not plan to study participants.[22] Even if a handful of IDA programs has been successful, it would be difficult to extrapolate the results to the population at large because participants are self-selecting.[23] In sum, a much more thorough investigation of IDAs would be needed before policymakers could draw any sound conclusions about IDAs' ability to increase the savings of and build assets for low-income workers, particularly as a nationwide program of voluntary add-on accounts.

Although no model is perfect, participation in 401(k) plans with employer matches gives policymakers a reasonable estimate of likely participation in USAs and other voluntary accounts. Experience with private retirement plans shows that participation rates rise proportionately with income: the greater one's income, the greater one's likelihood of participating. That means America's lowest-income workers, who most need private retirement accounts, are the least likely to participate in or benefit from voluntary add-on accounts. The reality is that many low-income workers simply earn too little or choose not to deposit significant assets in those accounts. That will not be changed by giving them a place in which to deposit money they may not have or choose to spend on other things.

Add-Ons Established with General Tax Revenue

Because many lawmakers suspect that low-income workers will not participate in voluntary accounts, they have begun to look for other sources of funding, including general tax revenue. One such proposal was introduced by Rep. John Kasich (R-Ohio), House Budget Committee chairman. His legislation, the Personal Retirement Savings Account Act of 1998, would put 80 percent of any federal budgetary surplus into Social Security Plus accounts for all workers. Workers would have a limited number of options for investing their Social Security Plus money, and they would own their accounts. The accounts would be supplementary to the Social Security system, and they would not affect the program in any way. Kasich's press release puts it this way: "These accounts would be in addition to the existing Social Security System, which would not be affected by Kasich's legislation."[24]

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Kasich's proposal and others like it are politically popular, primarily because the "spin" gives them the appearance of improving Social Security (thus, the name Social Security Plus accounts), whereas, in truth, they do not touch the Social Security system.[25] As Kasich explains, "It is a whole new way to help Americans save for retirement while at the same time setting the stage for a solution to the long-term problems facing Social Security."[26] In other words, these accounts would supplement Social Security but would not directly affect the program in any way.

Proposals that would fund personal accounts by divvying up budget surpluses are time limited; after all, how will the government fund the accounts once the surpluses have been spent? Director of the National Economic Council Gene Sperling has said that the USAs will cost $38 billion a year once they are fully established.[27] Even if low participation rates make the accounts less costly than the administration has estimated, when the surpluses dry up, either federal deposits in the accounts will stop, or, more likely, taxpayers will continue to bear the cost of an expansive new program.[28]

It is important to note that some policymakers argue that placing the surplus in personal accounts is not an entitlement but a tax cut. For example, Clinton calls USA contributions "tax credits" and has argued that "this is the right way to provide tax relief."[29] A better analysis would argue that government contributions are not "tax cuts" but "tax favors"—preferential tax treatment of workers who are willing to apply the credits to the government's retirement plan. As Deputy Secretary of the Treasury Larry Summers puts it, "This is a tax cut which individuals have no alternative but to save."[30] The refunds become a transfer or entitlement when taxpayers receive more from the government than they have paid in taxes.

Mandatory Add-Ons

Given the limits of voluntary contributions and accounts funded with general tax revenue, some policymakers hope to establish mandatory accounts that would be funded with an increase in the payroll tax. Edward M. Gramlich and Marc M. Twinney, members of the 1994–96 Advisory Council on Social Security, proposed the best-known plan of this kind.[31] Gramlich and Twinney would establish individual accounts by mandating an increase in the payroll tax of 1.6 percent.[32] Like most proponents of individual accounts, Gramlich and Twinney recognize that "somehow or other there must be some new saving soon to finance the nation's retirement system into the 21st century."[33] However, their mandatory add-on approach is a poor way to achieve that goal.

To be sure, mandating savings avoids some of the problems associated with voluntary add-ons; namely, that mandatory is not voluntary—all workers would participate. But funding individual accounts by raising the payroll tax introduces problems of its own. In particular, the payroll tax is extremely regressive, which means that it takes a larger portion of total income from low- and average-wage workers than from high-wage workers.[34] That disproportionate burden is compounded by the fact that the amount of income subject to the payroll tax is capped at $72,600.[35] Therefore, any increase in the payroll tax necessarily weighs most heavily on low- and average-wage earners, who can least afford to pay more.

Increasing the payroll tax would also reduce take-home pay, a situation that would leave workers with less money to pay for other important items such as education, home mortgages, health care, and so on. Again, low- and middle-wage workers can least afford such reductions in pay. In addition, some could actually fall below the poverty line, particularly since payroll taxes have no personal exemptions or standard deductions.

It is important to note that, unlike most add-on plans, Gramlich and Twinney's individual accounts were proposed in conjunction with other Social Security reforms, including increasing the retirement age, cutting spousal benefits, and lengthening the benefit computation period. They designed their proposal so that the revenue generated by the individual accounts would offset the benefit cuts. Gramlich and Twinney explain, "These [accounts] in effect make up for the benefit cuts and provide, on average, the same benefits as under present law."[36] Regardless of whether the combined reforms could bring Social Security into long-term actuarial balance, the Gramlich-Twinney plan does nothing to improve a host of other problems associated with Social Security and actually makes some of them worse.

For example, increasing the payroll tax without increasing benefits effectively reduces Social Security's rate of return. Already, workers born after 1970 will receive less than 1 percent return on their payroll taxes, assuming Social Security manages to pay all benefits promised under current law.[37] Laurence Kotlikoff, professor of economics at Boston University and Social Security expert, reports, "Today's 18-year-olds in every economic class will pay more in taxes than they receive in benefits."[38] If payroll taxes are increased, that rate of return will worsen further.[39]

In addition, the proposal would not alleviate the high poverty rates under Social Security. Currently, an estimated 20 percent of widowed women, divorced women, and never-married women live in poverty while collecting Social Security. Poverty rates during retirement for African-American and Hispanic-American women are 28 percent.[40] Increasing the payroll tax will simply extract more money from those women during their working years and give them no more financial security at retirement. That is an outrageous proposition, considering that virtually all women (and men) would be better off under a system of personal retirement accounts funded through the payroll tax.[41]

Add-Ons with Clawbacks

The most recent proposals for add-on accounts include "clawbacks"—provisions that would reduce promised Social Security benefits by the amount of revenue generated by the new accounts. Like other add-ons, these accounts would require a new revenue stream.

House Ways and Means Committee chairman Bill Archer (R-Tex.) and Social Security Subcommittee chairman Clay Shaw (R-Fla.) recently proposed this approach. Under the Archer-Shaw plan, the accounts would be funded with general revenue. The government would place an amount equal to 2 percent of a worker's earnings, in the form of an income tax credit, in a personal account. For instance, a worker making $50,000 would receive a credit worth $1,000. Any revenue generated by the accounts would be offset at retirement by cutting an equivalent amount of Social Security benefits.[42] Because the amount of money that can be placed in the accounts is capped at $1,452 per year and because the plan requires 40 percent of the funds to be placed in bonds, even the highest-wage workers would be extremely unlikely to generate assets in excess of Social Security's promised benefits.[43]

Consider a person who works 40 years, contributes the maximum allowable amount per year ($1,452), and earns a 6 percent real rate of return. His account would generate an annuity worth roughly $865 per month, whereas Social Security promises to deliver roughly $1,800 per month.[44] Because the amount generated in the account is less than Social Security's promised benefits, that worker's retirement benefits would not increase. In short, the Archer-Shaw plan would require a vast infusion of general tax revenue just to make good on Social Security's promises; the additional revenue would not buy greater benefits for workers.

Regardless of whether infusing Social Security with general tax revenue could put the program into long-term actuarial balance, the clawback approach has a host of other problems. Like the Gramlich-Twinney plan, the proposal would do nothing to alleviate the high poverty rates low-wage workers face under Social Security. And, by requiring workers to pay more money into the system without increasing benefits, the proposal

Add-ons with clawbacks would reduce promised Social Security benefits by the amount of revenue generated by the new accounts.

The Archer-Shaw plan would require a vast infusion of general tax revenue just to make good on Social Security's promises; the additional revenue would not buy greater benefits for workers.

reduces Social Security's rate of return. Furthermore, workers would not own their accounts. If a worker dies before age 65, he can leave his account to his heirs. However, workers who retire are forced to surrender their accounts to the government in exchange for an annuity. Thus, in order to have a property right in your account, you have to die before age 65. A vast majority of workers who live to retirement would have no rights to their accounts.

Finally, workers are already paying more than enough to retire comfortably. For example, if a worker making $20,000 were able to put his payroll taxes in an account that provided an annual real return of 6 percent, he would retire with an account worth more than $380,000 after 40 years of work. Using a conservative annuity estimate, such an account would be able to provide a monthly payment of more than $1,450.[45] Social Security promises to provide such a worker with a monthly benefit of roughly $810.[46] In that light, it seems senseless to use more taxpayer funds to begin a new retirement program.

Conclusion

The idea of establishing individual retirement accounts alongside Social Security is a favorite among politicians because they can talk about the positive aspects of individual accounts—worker empowerment, personal ownership, and wealth creation—while avoiding the more unpleasant but central issue of Social Security reform. Whether funded through voluntary contributions, general revenue, or payroll tax increases, in the end those plans simply take more money from working Americans while ignoring Social Security's financial crisis. Social Security would still face a $9.5 trillion unfunded liability. Making Social Security solvent would still require estimated benefit cuts of 30 percent or tax increases of more than 5 percentage points.

Proponents of add-on accounts fail to recognize that workers are contributing enough to provide for a comfortable retirement. Dozens of studies have shown that if workers were able to invest their Social Security payroll taxes, they would retire with substantial sums in their accounts. It is senseless to force workers to pay above and beyond what is already enough to secure a comfortable retirement. Congress should simply let workers get a better deal on their current payroll taxes by allowing them to redirect that money into personal accounts.

Notes

1. *1999 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds* (Washington: Government Printing Office, 1999), p. 28.

2. The contribution would be in the form of a tax credit deposited directly into each worker's account. The credit would be "refundable," meaning a worker's credit could exceed his tax liability.

3. "President Clinton Introduces Universal Savings Accounts: Summary Documents," National Economic Council, April 14, 1999, p. 8.

4. Eligibility ends at $50,000 for single filers with pension coverage, $75,000 for head of household filers with pension coverage, and $100,000 for joint filers with pension coverage. There is no eligibility limit for people without pension coverage.

5. Sondra Beverly, "How Can the Poor Save? Theory and Evidence on Saving in Low-Income Households," Center for Social Development, Washington University, St. Louis, Missouri, Working Paper no. 97-3, 1997, p. 21, http://gwbweb.wustl.edu/users/csd/workingpapers/wp97-3.html. Beverly examines demographic variables as they relate to savings and discusses several theories of saving, including neoclassical economic, psychological, sociological, behavioral, and institutional theories.

6. Sixty-six percent of respondents said they had "too many current financial responsibilities." The second and third most common reasons were "I expect to have a pension" (26 percent) and "economic events, such as inflation and unemployment, are too uncertain" (26 percent). Paul Yakoboski, Pamela Ostuw, and Jennifer Hicks, "1998 Retirement Confidence Survey," Employee Benefits Research Institute, American Survey Education Council, and Matthew Greenwald and Associates, Washington, 1998, http://207.152.182.56/rcs/rcs-expectations.pdf.

7. Survey participants were asked, "Could you save $20 per week more for retirement?" Forty percent of workers who had saved for retirement said no, and 41 percent of workers who had not saved for retirement said no. Paul Yakoboski, Pamela Ostuw, and Jennifer Hicks, "What Is Your Savings Personality? The 1998 Retirement Confidence Survey," Employee Benefits Research Institute Issue Brief no. 200, August 1998, p. 11, http://www.ebri.org/rcs/T114.pdf.

8. Some policymakers might argue that the tax benefits of new retirement accounts would induce workers to save; however, most low-income workers pay little or no income tax, so the new accounts would be unlikely to alter their propensity to save.

9. Sixty-six percent of retirees depend on Social Security for at least half of their retirement income. Social Security Administration, "Fast Facts and Figures about Social Security," p. 7.

10. "Remarks of the President on Universal Savings Accounts," White House, Office of the Press Secretary, April 14, 1999.

11. A typical employer match is 50 cents for each $1 contributed by the worker, with the match ending when worker contributions reach 6 percent of salary. William Bassett, Michael Fleming, and Anthony Rodrigues, "How Workers Use 401(k) Plans: The Participation, Contribution, and Withdrawal Decisions," *National Tax Journal* 11, no. 2 (June 1998): 265.

12. Ibid., p. 284.

13. Ibid., pp. 270, 276. Low-income workers have greater difficulty participating in 401(k) plans because of their low incomes. In addition, the authors cite other reasons for lower participation among low-income workers: low-income workers benefit less from the tax-deferred nature of 401(k) plans than do high-income workers; they are more likely to be liquidity constrained and therefore have better uses for their funds than retirement saving; some are more likely to be covered by means-tested programs and therefore face high implicit tax rates on savings; and Social Security income replacement rates are higher for low-income workers, reducing their incentive to save. Plan and household characteristics are also important influences on the decision to participate in 401(k) plans.

14. Ibid., p. 275.

15. The median income of households in 1996 was $35,492. Bureau of the Census, *Statistical Abstract of the United States: 1998* (Washington: Government Printing Office, 1998), p. 471.

16. Virtually all the Individual Development Account proposals have been guided by work of the Corporation for Enterprise Development in Washington and the Center for Social Development at Washington University in St. Louis. See Michael Sherraden et al., "Downpayments on the American Dream Policy Demonstration: A National Demonstration of Individual Development Accounts," Center for Social Development, Washington University, St. Louis, Missouri, January 1999, pp. 3–4.

17. Ibid., pp. 1, 6.

18. Ibid., pp. 59–63.

19. Ibid., p. 66.

20. Brian Grossman, "What We Know about the Success of Individual Development Accounts," Corporation for Economic Development, Washington, March 1997, p. 5, http://www.cfed.org/idas/documents/whatweknow.htm.

21. NFCDCU would not release its data to the Cato Institute for examination after repeated requests.

22. Karen Edwards, "Individual Development Accounts: Creative Savings for Families and Communities," Center for Social Development, Washington University, St. Louis, Missouri, Policy Report, 1997, pp. 1–30.

23. Author's telephone conversation with Michael Sherraden, professor of social development at Washington University, St. Louis, Missouri, March 23, 1999.

24. John Kasich, "Kasich Introduces Bill Returning Surpluses to Americans for Retirement Savings," Press release, March 12, 1998.

25. See, for instance, Sen. Bill Roth (R-Del.), "Personal Retirement Accounts Act of 1998," http://thomas.loc.gov/cgi-bin/query/z?c105:S2369. Roth would use a portion of the budget surplus to establish individual accounts based on a progressive formula.

26. Kasich.

27. Gene Sperling and Larry Summers, White House, Office of the Press Secretary, Press briefing, April 14, 1999.

28. For further discussion, see David John, senior policy analyst for Social Security at the Heritage Foundation, "Testimony before the House Committee on Commerce, Subcommittee on Finance and Hazardous Materials," February 25, 1999, http://com-notes.house.gov/cchear/hearings106.nsf/fhmmain.

29. "Remarks of the President on Universal Savings Accounts."

30. Sperling and Summers.

31. Robert M. Ball et al., "Option II: Publicly-held Individual Accounts," in *Report of the 1994–1996 Advisory Council on Social Security,* vol. 1, *Findings and Recommendations* (Washington: Government Printing Office, 1997), pp. 28–29.

32. "Defined contribution individual accounts in the amount of 1.6 percent of covered payroll would be created and funded by employee contributions. Individuals would have constrained choices on how the funds were to be invested." Ibid., p. 28.

33. Edward Gramlich and Marc Twinney, "The Individual Accounts Plan," in *Report of the 1994–1996 Advisory Council on Social Security,* p. 155.

34. For a discussion of how payroll taxes affect low-wage earners, see Michael Kremer, "Restructuring Social Security Taxes," Brookings Institution Policy Brief no. 40, Washington, December 1998, pp. 1–8.

35. The maximum taxable income in 1999 is $72,600. *1999 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds,* p. 2.

36. Gramlich and Twinney, p. 155.

37. Laurence Kotlikoff, "Privatizing Social Security," National Center for Policy Analysis Report no. 217, July 1998, p. 15.

38. Ibid., p. 12.

39. Some critics argue that the proposed increase in the payroll tax is not a "tax," because the money would be put into accounts owned by the workers. Outside the Beltway, however, most workers would consider this a tax. It reduces take-home pay, and politicians tell workers when and how to spend their money. For a detailed discussion, see Peter Ferrara and Michael Tanner, *A New Deal for Social Security* (Washington, Cato Institute, 1998), pp. 122–25.

40. National Economic Council Interagency Working Group on Social Security, "Women and Retirement Security," October 27, 1998, p. 12–13.

41. Darcy Olsen, "Greater Financial Security for Women with Personal Retirement Accounts," Cato Institute Briefing Paper no. 38, July 20, 1998.

42. The credit would be "refundable," meaning that a worker's credit could exceed his tax liability. "Archer Statement on Introduction of Social Security Guarantee Plan," Committee on Ways and Means, Press release, April 28, 1999.

43. The credit is capped at the Social Security wage base, so no one would receive a credit in excess of $1,452 in 1999 (2 percent of $72,600). "The Social Security Guarantee Plan: Saving and Strengthening Social Security without Raising Taxes or Cutting Benefits," Committee on Ways and Means, Press release, April 28, 1999.

44. The annuity was calculated by using the 17.3-year life expectancy provided for a 65-year-old man in the year 2035, given on page 62 of the *1999 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds.* Calculations also assume an annuitization charge of 20 percent.

45. "The Social Security Guarantee Plan."

46. Calculations by Carrie Lips, Social Security analyst, Cato Institute.

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