

*A Better Deal at Half the Cost*  
*SSA Scoring of the Cato Social Security*  
*Reform Plan*

by Michael Tanner

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**Executive Summary**

The Social Security Administration's Office of the Actuary has officially "scored" the Individual Social Security Investment Program Act (HR 530), introduced by Reps. Sam Johnson (R-TX) and Jeff Flake (R-AZ). That legislation is based on the Cato Institute's 6.2 Percent Solution. (There are slight differences between the Cato plan and the final draft of the legislation, but these would not significantly change the scoring.)

According to SSA's actuaries, the 6.2 Percent Solution would eliminate Social Security's long-range actuarial deficit and restore the system to permanent "sustainable solvency." The legislation compares very favorably to other Social Security

reform plans. In terms of giving workers more control and ownership of their retirement funds, the 6.2 Percent Solution clearly provides the most "bang for the buck." By 2046, the system would begin running surpluses, allowing any short-term debt to be repaid. Indeed, by the end of the 75-year actuarial window, the system would be running surpluses in excess of \$1.8 trillion (in constant \$2005).

The SSA analysis shows that the 6.2 Percent Solution can provide large individual accounts while restoring Social Security to permanent sustainable solvency, and can do so in a fiscally responsible manner.

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**Under this proposal, workers under the age of 55 would have the option of diverting their half of the Social Security payroll tax to individual accounts.**

## **Introduction**

On February 17, 2004, the Cato Institute published “The 6.2 Percent Solution: A Plan for Reforming Social Security,” a comprehensive proposal for creating privately invested, individually owned accounts as part of an overall reform of the Social Security system.<sup>1</sup>

Under this proposal, workers under the age of 55 would have the option of diverting their half of the Social Security payroll tax (6.2 percent of wages) to individual accounts. The employer’s portion of the payroll tax would continue to be paid into the Social Security system to provide survivors’ and disability benefits, as well as to partially fund continuing benefits for those already retired or nearing retirement. Workers choosing the individual account option would forgo any future accrual of Social Security retirement benefits. However, those workers who have already paid into the current Social Security system would receive credit for accrued benefits in the form of a recognition bond. This fully tradable bond would be a zero-coupon note that would mature on the date of the recipient’s normal retirement age.

Workers who do not choose the individual account option would continue to pay into and receive benefits from the current Social Security system. However, for those workers, the initial Social Security benefit formula would be adjusted to reflect price indexing rather than the current wage indexing.<sup>2</sup> The result would be to restore Social Security benefits to a level payable with Social Security’s available revenue, while ensuring that future retirees continue to receive the same level of benefits as those retiring today, on an inflation-adjusted basis. (This change would be phased in over a 35-year period, beginning in 2014.)

The plan also called for establishing a new minimum Social Security benefit providing a significant increase over the current minimum benefit.

This proposal became the basis for legislation introduced on July 19, 2004, by Rep. Sam

Johnson (R-TX), along with 18 original cosponsors.<sup>3</sup> Johnson, together with Rep. Jeff Flake and 10 cosponsors, reintroduced the bill in the 109th Congress, on January 21, 2005.<sup>4</sup> The legislation was submitted to the Social Security Administration for official scoring as to its impact on the federal budget and Social Security solvency. On February 15, 2005, the SSA’s Office of the Actuary (OACT) issued its report, concluding that the Johnson-Flake bill would restore Social Security to permanent, sustainable solvency.<sup>5</sup> The results of OACT’s report are reflected below.

(There are slight differences between the Cato plan as originally written and the Johnson bill. These are noted where relevant, but would not significantly change the scoring.)

## **Scoring Assumptions**

Scoring of the 6.2 Percent Solution was done using actuarial assumptions consistent with the 2004 report of the Social Security Trustees. While there were minor changes in methodology between that report and the 2005 Trustees Report, most major demographic and economic assumptions (including fertility rates, death rates, immigration, productivity, inflation, wage-covered employment, unemployment, and Trust Fund interest rates) remained the same.<sup>6</sup> Therefore, the scoring results are likely to remain substantially consistent with the new report (the comparisons herein use Social Security assumptions from the 2005 Trustees Report).

In scoring the proposal, OACT did make a number of specific assumptions that affected the final outcome. Among these:

Although the Cato plan calls for a default portfolio of 60 percent stocks and 40 percent bonds (and the Johnson bill calls for a default portfolio of 65 percent stocks and 35 percent bonds), OACT nevertheless scores the bill using a 50/50 stock/bond portfolio. They base their decision on an assumption that, since both the Johnson-Flake bill and Cato plan would eventually completely replace Social Security’s defined benefit with a

defined contribution system, workers would be inclined to move their investments away from the default portfolio and into a more conservative one.<sup>7</sup>

The rates of return estimated for the investments were assumed to be 6.5 percent for equities, 3 percent for government bonds, and 3.5 percent for corporate bonds.<sup>8</sup> Although this is slightly below the historic return on equities, it is reasonable given evidence of a declining risk premium.<sup>9</sup> Administrative costs are estimated to be 25 basis points (one quarter of 1 percent of assets managed).

OACT assumes that workers make their decision as to whether to participate in the individual account option on a more or less rational basis. That is, if they will receive higher benefits from the traditional Social Security system (as adjusted for wage/price indexing), they will remain in the current system. If they can do better under individual accounts, they will choose them. Approximately 10 percent of workers age 54 are expected to choose individual accounts, with 100 percent participation among those age 40 and younger. Those between the ages of 54 and 40 participate in gradually increasing amounts.<sup>10</sup>

## Differences between the Cato Plan and the Johnson-Flake Bill

There are some small differences between the original Cato plan and the Johnson bill as introduced. These include the following:

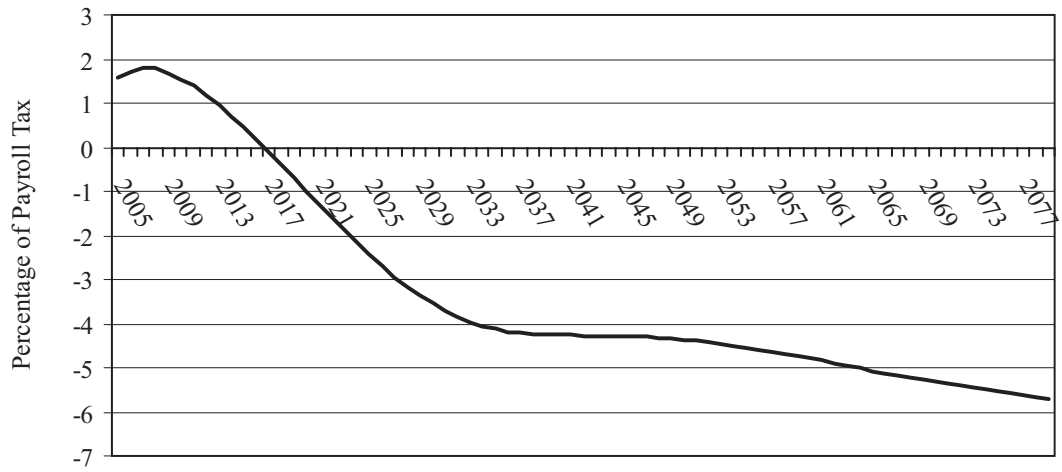
- **Additional Contributions.** Under the Cato plan, workers would be allowed to contribute an additional 10 percent of their wages to their accounts on a voluntary basis. However, under the proposed legislation, there are no provisions for additional contributions to the individual account.
- **Recognition Bonds.** The Cato plan called for the face value of the recognition bonds to be calculated by applying the existing Social Security benefit formula

(AIME/PIA) to the workers past covered earnings. The actuarial present value of this accrued-to-date benefit would then be calculated using a discount rate equal to the long-term opportunity cost of funds to the government (essentially the 30-year bond rate), or roughly 3.5 percent, and current age- and gender-specific expected mortality rates. The Cato plan also envisioned that “the recognition bonds may be valued at something less than the full present value of accrued benefits,” but did not specify the methodology for achieving this reduction. The Johnson-Flake bill uses the Social Security disability formula to calculate a worker’s accrued benefits (in effect, acting as though the worker became disabled as of the date that the worker chooses the individual account option). The value of the bond is slightly reduced by using a 40-year calculation period in determining the AIME, rather than 35.

- **Transition Financing.** The Cato plan prescribes three measures for covering transition costs. First, the plan proposes redirecting all of the taxes on Social Security that currently fund Medicare back to the Social Security program. Second, Cato has identified \$87 billion in corporate welfare that, if eliminated from the budget and saved, could be used to finance the transition. Finally, the Cato plan notes that any funds “recaptured” through corporate taxes before profits go to the investor could be used to offset the costs of the transition. The Johnson-Flake bill does not specify sources of transition financing, but indicates that general revenue transfers will pay for the transition.<sup>11</sup>
- **Age of Participation.** Under the Cato plan, workers “not currently in the labor force” must go into the new individual account system. Under the Johnson bill, workers under age 22 must go into the new individual account system.
- **Investment Options.** The Cato plan calls

**The proposal saves taxpayers some \$6.3 trillion.**

**Figure 1**  
**Social Security’s Payroll Tax Surplus or Deficit**



Source: The 2005 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds.

for a default investment option of a 60/40 stock/bond fund. The Johnson-Flake bill offers a default 65/35 stock/bond fund.

### **Fiscal Impact of the 6.2 Percent Solution**

The fiscal impact of Cato’s Social Security reform plan must be looked at in the context of Social Security’s current financial status. According to the intermediate projections of Social Security’s trustees, the program will begin running deficits—annual expenditures exceeding revenues—by 2017, with perpetually increasing cash shortfalls thereafter (Figure 1). Those shortfalls reach 4 percent of payroll within 30 years and rise to more than 6 percent by the end of the 75-year actuarial period. Thereafter, they continue to grow outside the actuarial window. Overall, the deficits total \$12.8 trillion on a present-value basis (using a perpetuity measure).<sup>12</sup>

Compared to the current system, the 6.2 Percent Solution would increase cash-flow shortfalls in the short term, but after 2045, the program’s cash-deficit would be eliminat-

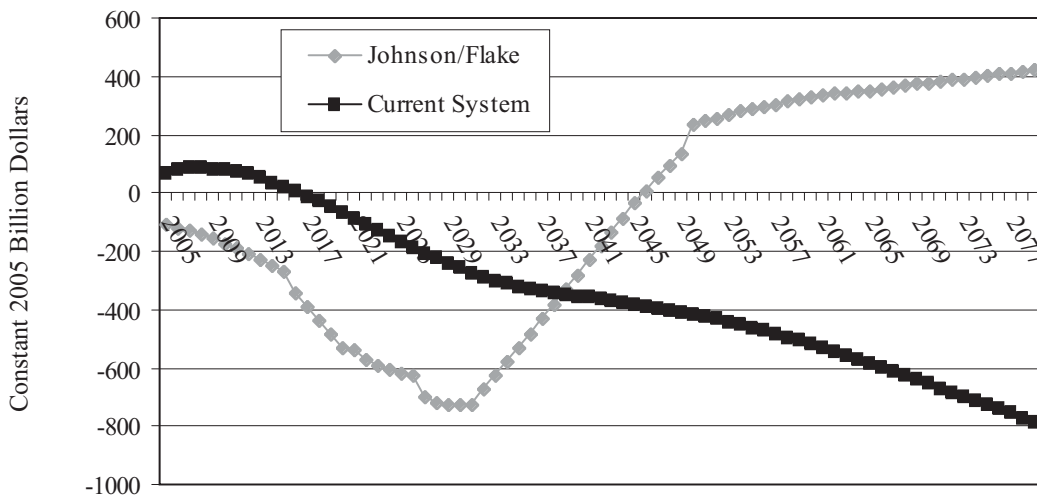
ed and the program would begin running permanent surpluses (Figure 2). Indeed, by the end of the standard 75-year actuarial window, the system would have accumulated surpluses of \$1.8 trillion.<sup>13</sup> Those surpluses would continue to grow outside the actuarial window. In short, under the 6.2 Percent Solution, Social Security would achieve permanent sustainable solvency. As OACT says, “The program would be expected to remain solvent throughout the 75-year projection period and for the foreseeable future beyond.”<sup>14</sup>

As calculated by OACT, the cost of moving to this system of individual accounts, commonly referred to as the transition cost, would be approximately \$6.5 trillion. While at first—and even second—glance, that looks like a great deal of money, the current unfunded obligations faced by Social Security run to \$12.8 trillion. In short, the 6.2 Percent Solution restores Social Security to permanent sustainable solvency—and it does so at roughly half the cost of preserving the current system. That is, the proposal saves taxpayers some \$6.3 trillion.

Another way to see how the proposal improves system finances is to look at the burden on future generations as measured by

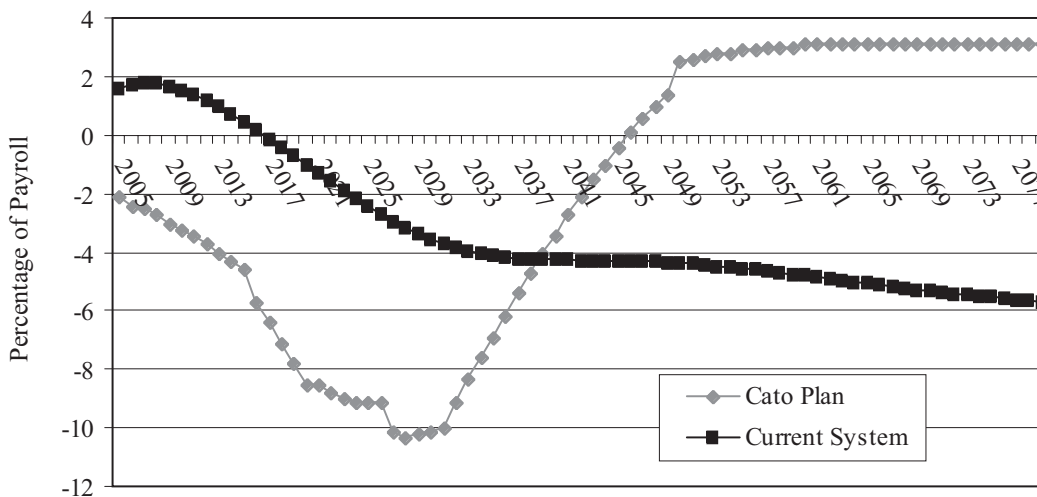
**Under the 6.2 Percent Solution, Social Security would achieve permanent sustainable solvency.**

**Figure 2**  
**Social Security Surplus/Deficit (in constant 2005 billions of dollars)**



Source: The 2005 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds. Memorandum from Stephen C. Goss and Alice H. Wade to Representative Sam Johnson, "Estimated Long-Range OASDI Financial Effects of a Proposal for Individual Social Security Investment Program Act of 2005 (H.R. 530)," February 15, 2005.

**Figure 3**  
**Social Security Surplus/Deficit (percentage of payroll)**



Source: The 2005 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds. Memorandum from Stephen C. Goss and Alice H. Wade to Representative Sam Johnson, "Estimated Long-Range OASDI Financial Effects of a Proposal for Individual Social Security Investment Program Act of 2005 (H.R. 530)," February 15, 2005. Memorandum from Stephen C. Goss to Representative Paul Ryan, "Estimated Financial Effects of the 'Social Security Personal Savings and Prosperity Act of 2004,'" July 19, 2004.

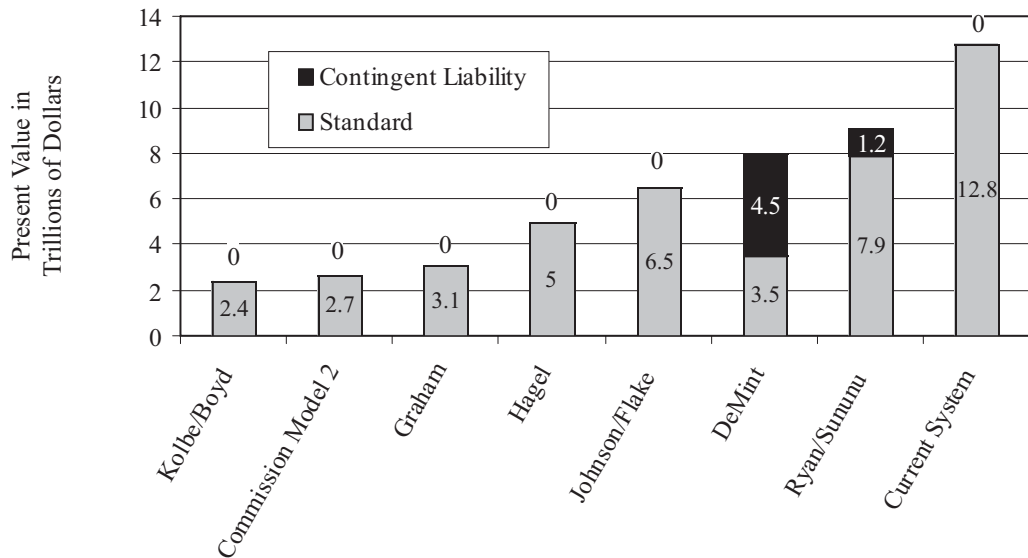
**Funds would become available to pay back any borrowing incurred during the transition.**

the level of Social Security expenditures as a percentage of payroll. As Figure 2 shows, under the current system, Social Security’s burden on future taxpayers is expected to rise from its current 11.13 percent of taxable payroll to 19.08 percent by 2078, and continue to rise thereafter. However, under the proposed individual account plan, the tax burden peaks at 17.06 percent of payroll in 2028, eventually declining to just 3.11 percent, an amount necessary to continue providing survivors’ and disability benefits. Because at that

point Social Security’s expenditures would be below anticipated revenues (continuing at 6.2 percent of payroll), funds would become available to pay back any borrowing incurred during the transition.

A further breakdown of the costs of the 6.2 Percent Solution is also informative. Roughly 62 percent of the up-front cost of the proposal is brought about not by allowing workers to redirect their payroll taxes to individual accounts, but because of the redemption of the recognition bonds.<sup>15</sup> In fact, it is the recogni-

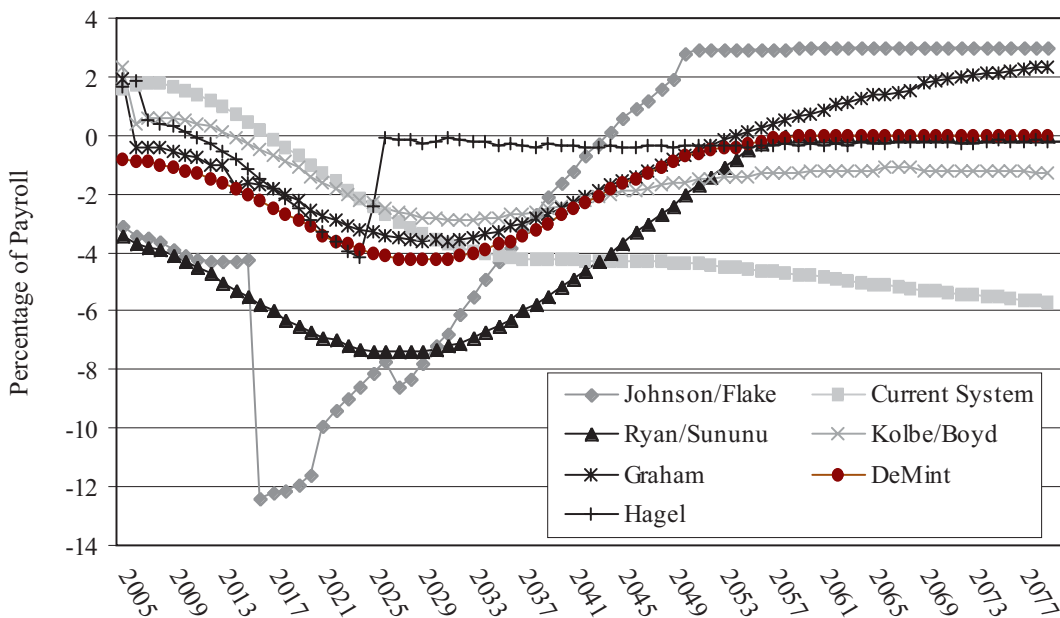
**Figure 4  
Net Cash Flow from the General Fund of the Treasury to OASDI Trust Funds (infinite horizon)**



Source: The 2005 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds. Memorandum from Stephen C. Goss and Alice H. Wade to Representative Sam Johnson, “Estimated Long-Range OASDI Financial Effects of a Proposal for Individual Social Security Investment Program Act of 2005 (H.R. 530),” February 15, 2005. Memorandum from Stephen C. Goss to Representative Paul Ryan, “Estimated Financial Effects of the ‘Social Security Personal Savings and Prosperity Act of 2004,’” July 19, 2004. Memorandum from Stephen C. Goss, Alice H. Wade, and Chris Chaplain to Representative Jim Kolbe and Representative Charles Stenholm, “Estimated OASDI Financial Effects of the ‘Retirement Security Act,’” February 11, 2004. Memorandum from Chris Chaplain and Alice H. Wade to Stephen C. Goss, “Estimated OASDI Financial Effects of ‘Social Security Solvency and Modernization Act of 2003’ introduced by Senator Lindsey Graham,” November 18, 2003. Memorandum from Stephen C. Goss to Representative Jim DeMint, “Estimated Financial Effects of H.R. 3177, the ‘Social Security Savings Act of 2003,’” September 26, 2003. Memorandum from Stephen C. Goss and Alice H. Wade to Senator Chuck Hagel, “Estimated Financial Effects of ‘The Saving Social Security Act of 2005,’” March 10, 2005. Memorandum from Stephen C. Goss and Alice H. Wade to Daniel Patrick Moynihan and Richard D. Parsons, “Estimates of Financial Effects for Three Models Developed by the President’s Commission to Strengthen Social Security,” January 31, 2002.

Note: Contingent liabilities refers to the cost of benefit guarantees if account investments underperform projections.

**Figure 5**  
**Social Security Surplus/Deficit**



Source: The 2005 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds. Memorandum from Stephen C. Goss and Alice H. Wade to Representative Sam Johnson, “Estimated Long-Range OASDI Financial Effects of a Proposal for Individual Social Security Investment Program Act of 2005 (H.R. 530),” February 15, 2005. Memorandum from Stephen C. Goss to Representative Paul Ryan, “Estimated Financial Effects of the ‘Social Security Personal Savings and Prosperity Act of 2004,’” July 19, 2004. Memorandum from Stephen C. Goss, Alice H. Wade, and Chris Chaplain to Representative Jim Kolbe and Representative Charles Stenholm, “Estimated OASDI Financial Effects of the ‘Retirement Security Act,’” February 11, 2004. Memorandum from Chris Chaplain and Alice H. Wade to Stephen C. Goss, “Estimated OASDI Financial Effects of ‘Social Security Solvency and Modernization Act of 2003’ introduced by Senator Lindsey Graham,” November 18, 2003. Memorandum from Stephen C. Goss to Representative Jim DeMint, “Estimated Financial Effects of H.R. 3177, the ‘Social Security Savings Act of 2003,’” September 26, 2003. Memorandum from Stephen C. Goss and Alice H. Wade to Senator Chuck Hagel, “Estimated Financial Effects of ‘The Saving Social Security Act of 2005,’” March 10, 2005.

tion bonds that cause the sudden large cost increase that Figure 3 shows beginning in 2018. In this context, it important to understand that recognition bonds cannot in any way be considered a new cost. They are simply the prepayment of already accrued Social Security benefits. An additional 1 percent of the cost can be attributed to providing the new minimum benefit.<sup>16</sup>

### “More Bang for Your Buck”

As Figure 4 shows, the 6.2 Percent Solution is less expensive than other large-account plans,

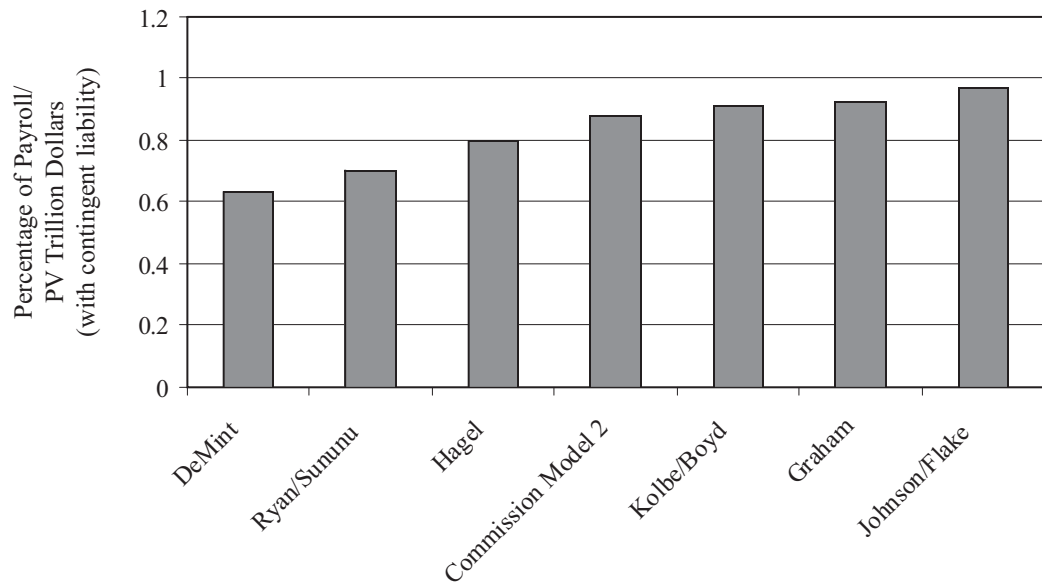
especially those plans that contain significant contingent liabilities as a result of guaranteeing benefit levels. Of course, plans with smaller accounts have lower short-term costs, but over the long run the 6.2 Percent Solution achieves substantially higher savings (Figure 5).<sup>17</sup>

Moreover, the 6.2 Percent Solution gives workers far more ownership and control than plans with smaller individual accounts. Indeed, Figure 6 shows that measured in terms of account size per trillion dollars of transition cost, the 6.2 Percent Solution achieves the most “bang for your buck.”

The size of individual accounts—the amount of payroll taxes that workers are

**The 6.2 Percent Solution gives workers far more ownership and control than plans with smaller individual accounts.**

**Figure 6**  
**Bang for Your Buck: Account Size Compared to General Revenue Transfers**



Source: The 2005 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds. Memorandum from Stephen C. Goss and Alice H. Wade to Representative Sam Johnson, “Estimated Long-Range OASDI Financial Effects of a Proposal for Individual Social Security Investment Program Act of 2005 (H.R. 530),” February 15, 2005. Memorandum from Stephen C. Goss to Representative Paul Ryan, “Estimated Financial Effects of the ‘Social Security Personal Savings and Prosperity Act of 2004,’” July 19, 2004. Memorandum from Stephen C. Goss, Alice H. Wade, and Chris Chaplain to Representative Jim Kolbe and Representative Charles Stenholm, “Estimated OASDI Financial Effects of the ‘Retirement Security Act,’” February 11, 2004. Memorandum from Chris Chaplain and Alice H. Wade to Stephen C. Goss, “Estimated OASDI Financial Effects of ‘Social Security Solvency and Modernization Act of 2003’ introduced by Senator Lindsey Graham,” November 18, 2003. Memorandum from Stephen C. Goss to Representative Jim DeMint, “Estimated Financial Effects of H.R. 3177, the ‘Social Security Savings Act of 2003,’” September 26, 2003. Memorandum from Stephen C. Goss and Alice H. Wade to Senator Chuck Hagel, “Estimated Financial Effects of ‘The Saving Social Security Act of 2005,’” March 10, 2005. Memorandum from Stephen C. Goss and Alice H. Wade to Daniel Patrick Moynihan and Richard D. Parsons, “Estimates of Financial Effects for Three Models Developed by the President’s Commission to Strengthen Social Security,” January 31, 2002.

**Social Security reform is about more than finances.**

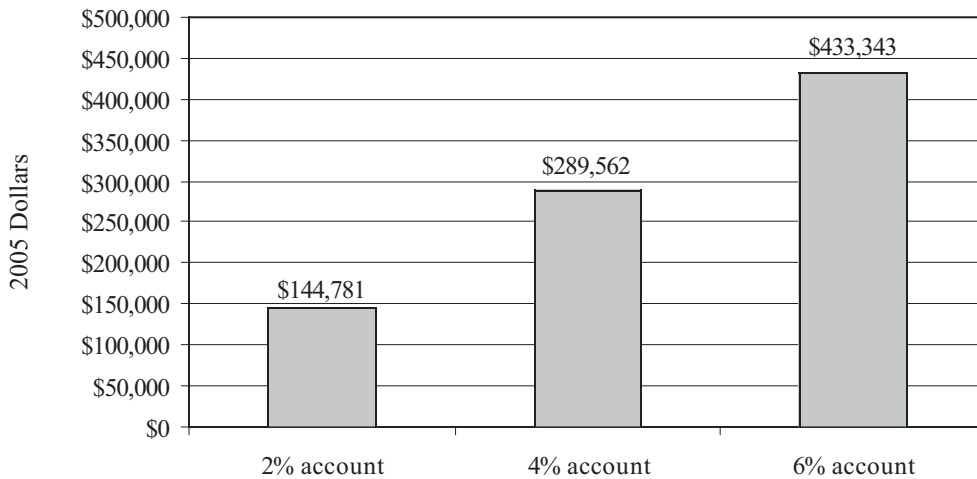
allowed to save and invest—is extremely important. Social Security reform is about more than finances. Indeed, if system finances were the only issue, we could simply raise taxes or cut benefits. True Social Security reform must also provide for increased rates of return and higher benefits, correct the inequities of the current system so as to treat working women, African Americans and others more fairly, and give low-income workers a greater opportunity to own and accumulate real wealth. By these measures, large accounts do a far better job of achieving true reform.

For example, increasing attention is being paid to the benefits of individual accounts as a way to give low-income workers an opportunity to build wealth. While any increase in wealth should be encouraged, we should also be honest enough to admit that for low-wage workers, very small individual accounts, such as the 2 percent of wages called for under some proposals, is simply not enough to allow for the accumulation of a real nest egg.

You can see the difference by considering the case of a 22-year-old worker earning \$35,000 per year (the current median wage).



**Figure 7**  
**Individual Account Value at Normal Retirement Age for a 22-Year-Old Medium-Wage Earner (65/35 stock/bond portfolio)**



Source: Cato Institute calculations.

A two percent account would allow the worker to accumulate just under \$145,000 by retirement. Four percent accounts, as suggested by President Bush, would double that to nearly \$290,000. However, 6.2 percent accounts would give the worker more than \$433,000 (Figure 7).<sup>18</sup> Given that these Social Security accounts may often be the only form of savings that low-income workers have, the more they are able to save, the better.

Finally, small accounts do little to advance the fundamental goals of reducing reliance on government and giving individuals greater responsibility for and control over their lives. However, under the 6.2 percent plan, government's role would eventually be limited to providing survivors' and disability benefits and ensuring a safety net that prevents seniors from falling into poverty. The vast majority of workers would be saving for their own retirement, taking control over their own lives.

### **Benefits under the 6.2 Percent Solution**

Opponents of individual accounts frequently suggest that the creation of such

accounts would result in cuts in the promised level of Social Security benefits. In doing so, these critics are confusing changes necessary to restore the system to balance with changes resulting from individual accounts. As noted above, Social Security faces unfunded liabilities of nearly \$12 trillion. Quite simply, unless there is a substantial increase in taxes, the program cannot pay the promised level of benefits.

That is not merely a matter of conjecture, but a matter of law. SSA is legally authorized to issue benefit checks only as long as there are sufficient funds available in the Social Security Trust Fund to pay those benefits. Once those funds are exhausted, in 2041 by current estimates, Social Security benefits will automatically be reduced to a level payable with existing tax revenues, approximately 74 percent of current benefit levels.<sup>19</sup> The gap between promised and payable benefits will continue to grow thereafter, reaching a 32 percent benefit reduction by the end of the actuarial period (Figure 8).<sup>20</sup>

Social Security must be restored to a sustainable level regardless of whether individual accounts are created. The proper baseline to use when discussing Social Security reform,

**Small accounts do little to advance the fundamental goals of reducing reliance on government and giving individuals greater responsibility for and control over their lives.**

**Average-wage workers who are roughly age 45 or younger today could expect higher benefits under the 6.2 Percent Solution than Social Security would otherwise be able to pay.**

therefore, is not benefits as scheduled, but the level of benefits that Social Security will actually be able to pay in the future.

As the Congressional Budget Office has put it:

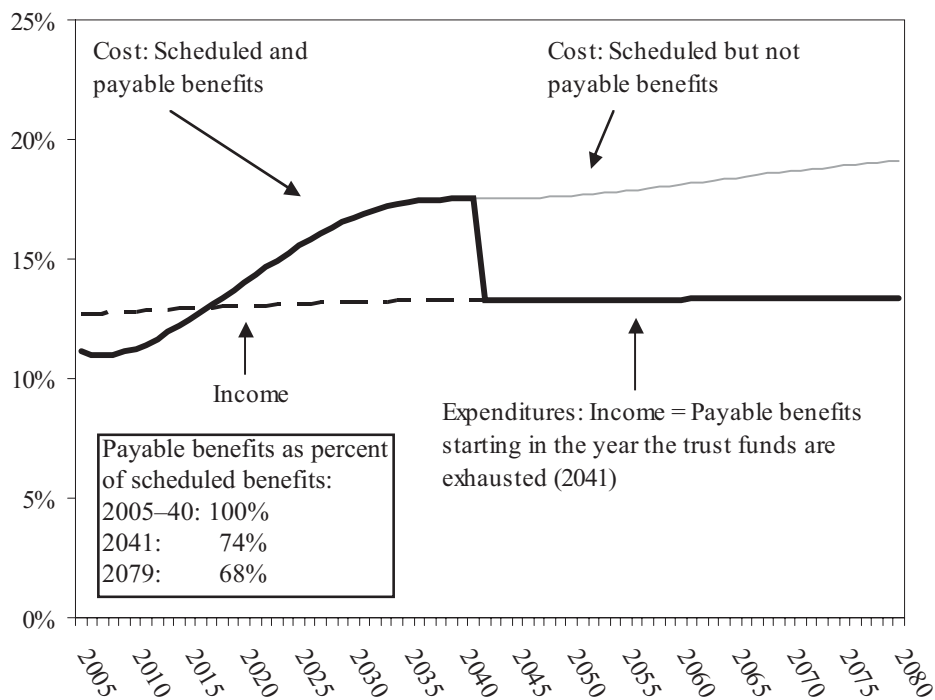
A number of recent proposals to reform Social Security call for changes in the program's benefits. The effects of those proposals are frequently illustrated by comparing the new benefits to those expected to arise under the policies put in place by current law—showing whether they would be higher or lower and by how much. However, because of scheduled changes in benefit rules, a growing economy, and improvements in life expectancy, the benefits prescribed under current law do not represent a stable baseline. Their value will vary significantly across future age cohorts. Thus, focusing on differences from current law

will not fully portray the effects of proposed benefit changes.<sup>21</sup>

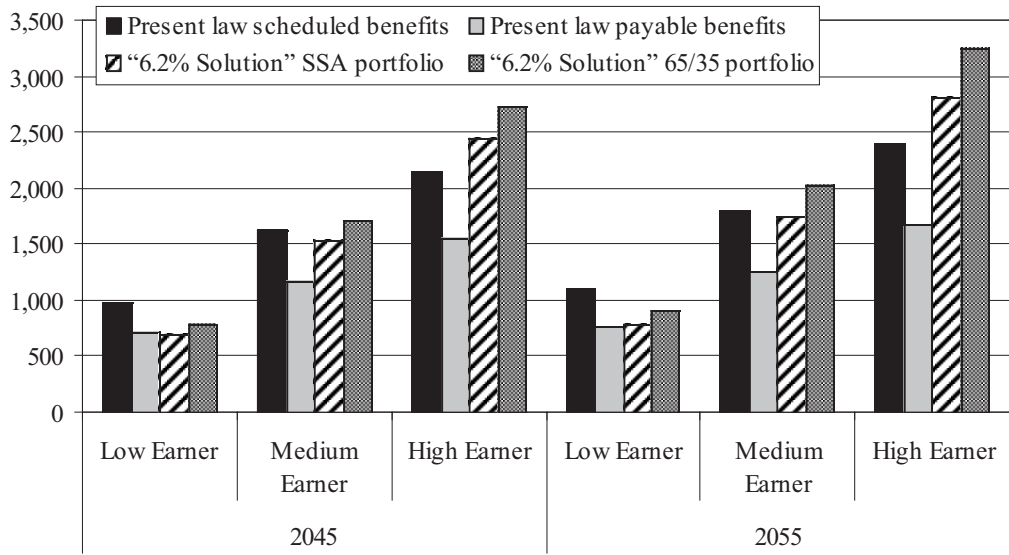
As scored by OACT, average-wage workers who are roughly age 45 or younger today could expect higher benefits under the 6.2 Percent Solution than Social Security would otherwise be able to pay. Older average-wage workers would not fare as well and presumably would not choose the individual account option, though higher-wage workers would still exceed payable benefits. Low-wage workers are a special case, since most would be covered under the new minimum benefit.

However, two assumptions that SSA uses in scoring the plan lead it to understate the proposal's benefits. First, constrained by Social Security's accounting rules, the actuaries assume that Social Security will pay full scheduled benefits until the Trust Fund is exhausted in 2042, after which benefits would be immediately reduced by 27 percent

**Figure 8  
Payable vs. Promised Benefits**



**Figure 9**  
**Monthly Retirement Benefits: Present Law vs. 6.2 Percent Solution**  
**(constant 2004 dollars)**



Note: Benefits for one spouse of a two-earner couple (spouse is same age with similar earnings).

to reach payable levels. But Congress is very unlikely to allow such an abrupt benefit reduction. Changes in benefits are much more likely to be phased in slowly, meaning that the “payable” baseline would be a much earlier basis for comparison.<sup>22</sup>

Second, as mentioned above, SSA scores the returns from individual accounts assuming a 50/50 stock/bond portfolio mix. It does this even though the Johnson bill calls for a default portfolio of 65/35 stocks to bonds. Substantively, the SSA assumptions result in the accounts earning approximately 11 percent lower returns than if the default were used for workers retiring in 2055; that is, those who would be contributing over their entire working lifetime. For those retiring earlier, the differential would be smaller, but would still matter.

SSA assumes that workers will transfer their funds out of the default portfolio in search of less risky investment options. That is a debatable assumption. Those low- and middle-income workers most concerned about risk are also those least likely to be

involved in the active management of their portfolios. It seems likely that a large percentage would leave their funds in the default portfolio out of simple inertia. Moreover, low-wage workers would be substantially protected from risk through the new minimum benefit. Indeed, many observers have criticized benefit guarantees precisely because they encourage workers to take on additional risk, creating a “moral hazard.”

If benefits were scored using the default portfolio, the monthly benefit would, as noted, be about 11 percent higher than estimated by SSA, making the advantage of individual accounts over traditional Social Security even more apparent (Figure 9).

## Conclusion

Cato’s proposed Social Security reform, as reflected in legislation by Reps. Sam Johnson and Jeff Flake, would restore Social Security to long-term and sustainable solvency, and would do so at roughly half the cost of sim-

**Cato’s proposed Social Security reform would restore Social Security to long-term and sustainable solvency, and would do so at roughly half the cost of simply propping up the existing program.**

**This is a proposal that would give workers ownership and control over their retirement income. It is a plan that is fiscally responsible and protects future generations of workers and taxpayers.**

ply propping up the existing program. But it would also do far more than that.

Younger workers who chose the individual account option could receive retirement resources substantially higher than under traditional Social Security. At the same time, it would treat women and minorities more fairly, and allow low-income workers to accumulate real wealth.

Most importantly of all, this is a proposal that would give workers ownership and control over their retirement income. It is a plan that is fiscally responsible and protects future generations of workers and taxpayers.

## Notes

1. Michael Tanner, "The 6.2 Percent Solution: A Plan for Reforming Social Security," Cato Institute Social Security Paper no. 32, February 17, 2004.

2. Currently the formula for determining initial Social Security benefits is adjusted to reflect national wage growth. Because wages generally grow faster than prices, each year's retirees receive higher benefits (after adjusting for inflation) than those retiring the year before. The 6.2 Percent Solution would change the formula so that it is adjusted by prices, or inflation, instead. This means that every group of retirees would receive the same initial benefits as previous retirees, adjusted for inflation, but not the benefit increases above inflation that are currently promised.

3. HR 4895.

4. HR 530.

5. Memorandum from Stephen C. Goss and Alice H. Wade to Rep. Sam Johnson, "Estimated Long-Range OASDI Financial Effects of the Individual Social Security Investment Program Act of 2004 (HR 530)," February 15, 2005. There is a debate about whether "sustainable solvency" necessarily involves "sustainability." The latter is permanent; the former is not. However, the Cato plan generates large surpluses beyond the 75-year horizon.

6. 2005 Report of the Board of Trustees of the Federal Old Age and Survivors Insurance and Disability Insurance Trust Funds, March 2005, Tables II.C.1., p. 6, and II.D.2., p. 13; 2004 Report of the Board of Trustees of the Federal Old Age and Survivors Insurance and Disability Insurance Trust Funds, May 2005, Table II.C.1, p. 6.

7. Goss and Wade, p. 7.

8. Ibid.

9. Michael Tanner, "The Better Deal: Estimating Rates of Return under a System of Individual Accounts," Cato Institute Social Security Paper no. 31, October 28, 2003.

10. Goss and Wade, p. 6.

11. Specification of transition financing sources, while interesting and perhaps politically important, has no impact on scoring, which concerns itself only with general revenue transfers.

12. 2005 Trustees Report. This measure does not count the Social Security Trust Fund as an asset, because the Trust Fund is also a liability of the federal government.

13. Goss and Wade, p. 12.

14. Ibid., p. 1.

15. Ibid., Tables 1B, 1C.

16. Ibid., Table 1A.

17. 2005 Trustees Report; Goss and Wade; Memorandum from Stephen C. Goss to Rep. Paul Ryan, "Estimated Financial Effects of the 'Social Security Personal Savings and Prosperity Act of 2004,'" July 19, 2004. Memorandum from Stephen C. Goss, Alice H. Wade, and Chris Chaplain to Reps. Jim Kolbe and Charles Stenholm, "Estimated OASDI Financial Effects of the 'Retirement Security Act,'" February 11, 2004. Memorandum from Chris Chaplain and Alice H. Wade to Stephen C. Goss, "Estimated OASDI Financial Effects of 'Social Security Solvency and Modernization Act of 2003' introduced by Senator Lindsey Graham," November 18, 2003. Memorandum from Stephen C. Goss to Rep. Jim DeMint, "Estimated Financial Effects of H.R. 3177, the 'Social Security Savings Act of 2003,'" September 26, 2003. Memorandum from Stephen C. Goss and Alice H. Wade to Sen. Chuck Hagel, "Estimated Financial Effects of 'The Saving Social Security Act of 2005,'" March 10, 2005. Memorandum from Stephen C. Goss and Alice H. Wade to Daniel Patrick Moynihan and Richard D. Parsons, "Estimates of Financial Effects for Three Models Developed by the President's Commission to Strengthen Social Security," January 31, 2002.

18. Of course, with smaller individual account proposals workers would continue to receive benefits under the traditional Social Security system in addition to the accumulations in their individual accounts. Therefore, the disparity in monthly benefits would not be as great as implied here. However, we are talking about the amount of accumulation that would be the worker's property, and, therefore, fully inheritable. This is what

one actually thinks of when one speaks of wealth.

19. In practice, rather than reduce each check sent to beneficiaries, the Social Security Administration would stop sending out checks altogether until it accumulated sufficient funds to pay “full” benefits. When those funds are exhausted, checks would again be withheld until sufficient funds accumulate, leading to checks starting and stopping several times over the course of a year. The net effect would be that total annual benefits would be reduced by the same amount as if each month’s benefits had been proportionally reduced.

20. 2005 Trustees Report, p. 8, Figure II.D2.

21. David Koitz, “Measuring Changes to Social Security Benefits,” CBO Long-Range Fiscal Policy Brief no. 11, December 1, 2003.

22. The cited benefit reductions are across the board, affecting not just new retirees, but also those who have been receiving Social Security checks for some time. If Congress were to try to avoid a political outcry by limiting the cuts to new retirees, the benefit reductions would be much greater.

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