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Perspectives on the President's Commission to Strengthen Social Security

by Andrew G. Biggs

Executive Summary

The President's Commission to Strengthen Social Security was appointed in May 2001 to formulate proposals that would protect benefits for today's retirees; enhance Social Security's fiscal sustainability for the long term; and give younger workers the opportunity to invest part of their payroll taxes in personal retirement accounts that they would own, control, and be able to pass on to their children. The commission's three reform proposals, delivered to the president in December, fulfill those obligations.

The commission's interim report, issued in August 2001, cast doubt on the current system's trust fund financing and questioned the program's progressivity. Those findings generated considerable public controversy. The commission's final report, which put forward three distinct plans to strengthen Social Security through personal accounts, generated even more debate.

Although the commission's three plans cover a spectrum of approaches, the proposals have important characteristics in common. All three plans would provide higher benefits than the current system can pay, and lower-income workers—who opponents of private accounts claim to be most concerned about—would receive higher benefits than are promised under the current system. Moreover, all three plans would produce those benefits at a cost lower than that of maintaining the current program.

The commission attracted significant criticism from opponents of personal accounts. What the commission's work did not attract was substantive counterproposals on how to keep Social Security solvent and sustainable over the long term in the absence of personal accounts. The next stage of the Social Security debate is for account opponents to put their own proposals on the table. Inaction, the "policy" most often put forward by opponents, is not a viable option.

A review of the arguments and evidence finds that the personal account-based proposals from the President's Commission provide a better way to pre-fund future Social Security benefits than the current program's trust fund mechanism; that protections against poverty in old age would be increased and progressivity enhanced; that workers would have the right to own, control, and pass on their Social Security savings; and that personal account-based proposals have the capacity to pay higher benefits at lower long-run costs than the traditional pay-as-you-go method of financing Social Security.

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Introduction

In May 2001 President Bush appointed the President's Commission to Strengthen Social Security to formulate proposals that would maintain Social Security's promise for today's retirees while improving that promise for younger workers through personal accounts. That was their task, and in the end they accomplished it well.

The commission began its work with an interim report, issued in August 2001, outlining the state of the current program. The interim report generated significant controversy—particularly its criticism of the Social Security trust fund and the overall progressivity of the program.

The commission's final report and recommendations, delivered to the president in December 2001, contains three separate reform proposals based on personal retirement accounts. Although the plans encompass a broad range of ideas on how to maintain Social Security, each would pay benefits at least as high as the current program at a lower long-term cost, while giving workers the opportunity to build assets and wealth in personal accounts that they would own and control.

The commission's Plan 1 would do nothing more than give workers the option to voluntarily invest a portion of their Social Security payroll taxes in a personal retirement account. Because it makes no other changes to the system, it is politically attractive in the short term, but it does not address long-term concerns. Nevertheless, even this "accounts only" approach would pay higher benefits to all retirees while reducing long-term general revenue costs by 8 percent compared with the current program.

Plan 2 would go further, by allowing workers to voluntarily invest 4 percent of their wages up to $1,000 while indexing traditional benefits for new retirees to increases in prices rather than wages. This step would make Social Security sustainable indefinitely, reducing the long-term general revenue costs of supporting the program by 68 percent while paying retirees higher benefits than under current law.

Plan 3 incorporates a combination add-on and carve-out account, wherein a worker who voluntarily invests an additional 1 percent of his wages may redirect 2.5 percentage points of his payroll taxes, up to $1,000 annually. Plan 3 would pay benefits higher even than those promised by Social Security while putting 52 percent less pressure on general revenues than the current program. More problematic is the fact that Plan 3 incorporates new, ongoing general revenue transfers to the traditional pay-as-you-go program. Although these funding increases are consistent with the desire of the plan's sponsors for workers to continue to receive a combination of defined benefit and defined contribution benefits that exceed levels promised by the current program, it is believed that revenues are better applied to establishing the funded portion of Social Security reform rather than bolstering the existing pay-as-you-go element.

The latter two plans incorporated significant new protections for the most vulnerable Americans. Both plans would guarantee 30-year minimum-wage workers a retirement above the poverty line, a promise the current program cannot make. This guarantee would lift up to one million retirees out of poverty by 2018. Survivors' benefits for lower-wage individuals would be increased to 75 percent of the couple's prior benefit, increasing benefits for two to three million retired women.

The commission's plans would also assist divorced persons, who for the first time would gain a right to benefits on the basis of their spouses' earnings even if they divorced before 10 years of marriage. Coupled with the progressive funding of the personal accounts in Plans 2 and 3, these steps make reform based on personal accounts unequivocally beneficial to lower-income Americans.

The commission attracted considerable criticism from opponents of personal accounts. What the commission's work did not attract was substantive counterproposals on how to keep Social Security solvent and sustainable over the long term in the absence of personal accounts. The next stage of the Social Security debate is for account opponents to make their case and for the public and policymakers to decide what they want. Inaction, the "policy" most often put forward by account opponents, is not a viable option.

Background

The President's Commission to Strengthen Social Security was appointed with a mandate to "provide bipartisan recommendations to the President for modernizing and restoring fiscal soundness to the Social Security System."[1]

The 16-member commission, split evenly between Democrats and Republicans, was co-chaired by former senator Daniel Patrick Moynihan (D-N.Y.) and Richard Parsons, soon to be chief executive officer of AOL Time Warner. The other members of the commission included

- Leanne Abdnor (R), former vice president of the Cato Institute and executive director of the Alliance for Worker Retirement Security;
- Sam Beard (D), founder and president of Economic Security 2000;
- John Cogan (R), former deputy director of the Office of Management and Budget, now a resident scholar at the Hoover Institution at Stanford University;
- Bill Frenzel (R), former U.S. representative from Minnesota, now a resident scholar at the Brookings Institution;
- Estelle James (D), consultant with the World Bank, and lead author of the Bank's influential 1994 book, *Averting the Old Age Crisis*;[2]
- Robert Johnson (D), chief executive officer of Black Entertainment Television;
- Gwendolyn King (R), former commissioner of Social Security (1989–92);
- Olivia Mitchell (D), professor of insurance and risk management at the University of Pennsylvania's Wharton School and executive director of the Pension Research Council;
- Gerry Parsky (R), former assistant secretary of the Treasury (1974–77), now chairman of Aurora Capital Partners;
- Tim Penny (D), former U.S. representative from Minnesota, now senior fellow at the University of Minnesota's Hubert H. Humphrey Institute of Public Affairs;
- Robert Pozen (D), former vice chairman of Fidelity Investments, now lecturer in public policy, Harvard University;
- Mario Rodriguez (R), president, Hispanic Business Roundtable;
- Thomas Saving (R), professor of economics at Texas A&M University and public trustee of the Social Security program; and
- Fidel Vargas (D), vice president of Reliant Equity Investors and member of the 1994–96 Advisory Council on Social Security.

The commission, which was instructed to submit its recommendations to President Bush by December 21, 2001, worked according to the following principles outlined by the president.

1. Modernization must not change Social Security benefits for retirees or near-retirees.
2. The entire Social Security surplus must be dedicated to Social Security only.
3. Social Security payroll taxes must not be increased.
4. Government must not invest Social Security funds in the stock market.
5. Modernization must preserve Social Security's disability and survivors' components.
6. Modernization must include individually controlled, voluntary personal retirement accounts, which will augment the Social Security safety net.

These principles were the starting point for the commission's deliberations. However, they did not dictate the commission's conclusions. The president's principles are flexible enough, in fact, not to rule out the approach advocated by former vice president Gore—retention of the traditional Social Security defined benefit, augmented by supplementary personal accounts. Nor do they dictate that accounts must be financed by redirecting existing payroll taxes. Indeed one of the commission's plans includes new contributions by workers. In short, although critics claimed that the commission was "stacked" in a certain direction, the principles it worked under—not to mention the proposals it arrived at—were anything but preordained.

The next stage of the Social Security debate is for account opponents to make their case.

Interim Report

The commission's first task was to complete an interim report[3] outlining the challenges facing the current Social Security system—that is, to define the problem the commission and the country have to address. Given the intense reaction to the report from reform opponents, it seemed at times that the commission, rather than the program, was viewed as the problem. Nevertheless, despite allegations that the report contained numerous factual errors,[4] it in fact holds up quite well under scrutiny.

In many ways, the commission's interim report simply echoed the annual reports of Social Security's trustees, who noted that the program faces substantial and ongoing deficits over the long term. Much like the trustees, the commission urged that reform be undertaken sooner rather than later.

In its interim report, the commission reached the following conclusions regarding the current Social Security program, which complement the principles for reform outlined by the president.

- If we are to support tomorrow's retirees without overburdening tomorrow's workers, this generation of Americans must save and invest more.
- The existing Social Security program does not save or invest for the future. It was not designed to facilitate saving, and the political process cannot be relied upon to save on behalf of American families.
- Under the existing system, Americans will soon face inescapable choices: cut Social Security benefits, raise taxes, cut other government spending, or borrow on an unprecedented scale.
- Arguments for doing nothing amount to direct advocacy of one or more of these options.[5]

In addition, the commission established eight criteria by which to evaluate proposals to strengthen the Social Security system:

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1. Encouragement of workers' and families' efforts to build personal retirement wealth by giving citizens a legal right to a portion of their benefits.
2. Equity of lifetime Social Security taxes and benefits, both between and within generations.
3. Adequacy of protection against income loss due to retirement, disability, death of an earner, or unexpected longevity.
4. Encouragement of increased personal and national saving.
5. Rewarding individuals for actively participating in the workforce.
6. Movement of the Social Security system toward a fiscally sustainable course that reduces pressure on the remainder of the federal budget and can withstand economic and demographic changes.
7. Practicality and suitability to successful implementation at reasonable cost.
8. Transparency: Analysis of reform plans should measure all necessary sources of tax revenue, and all benefits provided, including those from the traditional system as well as from personal accounts.[6]

Taken together, these criteria provide a basis for formulating and assessing proposals to reform Social Security.

The policy reasons for reform are fundamentally demographic. Because Social Security is a pay-as-you-go system, in which taxes paid by today's workers are used to pay benefits for today's beneficiaries, the relative sizes of the working and retired populations are crucial to determining the tax rates or benefit levels the system must apply.

To illustrate these basic but important relationships, the commission's interim report contained a one-page section entitled "Basic Social Security Math." Although the trustees' long-term projections encompass myriad economic factors such as wage growth, interest rates, changes in hours of work and general workforce participation, the basic math of pay-as-you-go Social Security financing is driven almost entirely by demographics.

Consider the equation presented by the commissioners:

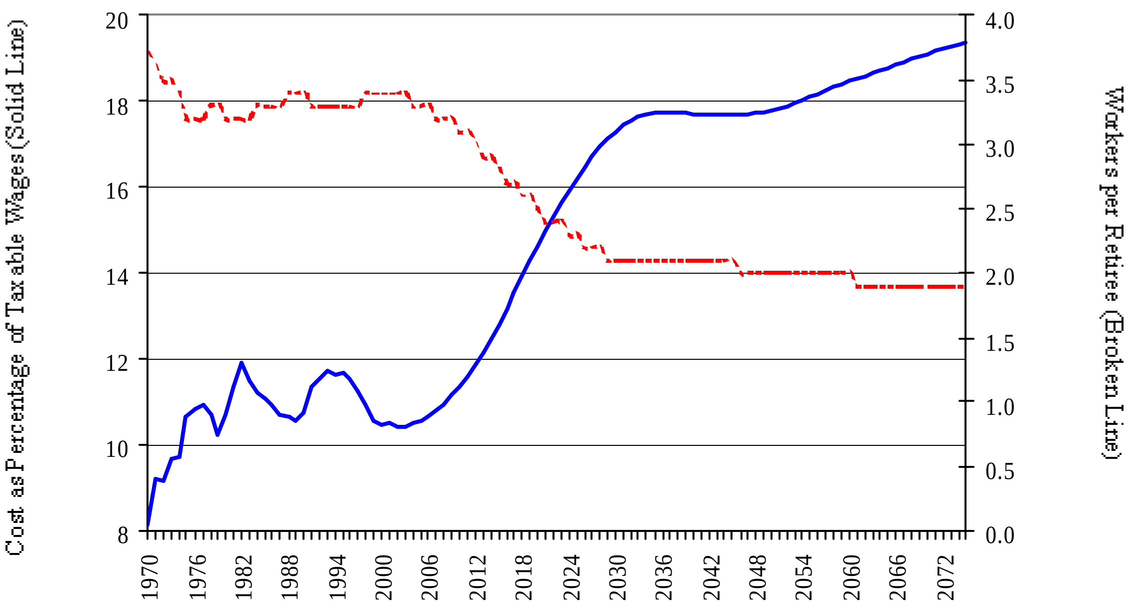
$$\frac{\textit{Average benefits as percentage of average taxable wage}}{\textit{Worker-to-beneficiary ratio}}$$

$$= \textit{Program cost as percentage of average wage}$$

Because today's Social Security benefit averages 36 percent of the average worker's wage, and because there are currently 3.4 workers per beneficiary, the payroll tax required to support today's beneficiary is around 10.5 percent of his earnings (36/3.4 = 10.5). Because today's payroll tax rate is set by law at 12.4 percent of wages, Social Security currently runs a surplus.

Notice how the above equation is structured, with one variable that we assume to be exogenous (i.e., whose value is not determined by the other variables): the worker-beneficiary ratio.[7] If the number of workers per retiree falls, then either the average benefit must fall (to maintain a constant

Figure 1
Social Security's Cost Rises as the Population Ages



Source: *The 2001 Annual Report of the Board of Trustees of the Federal Old-Age and Survirvors Insurance and Disability Insurance Trust Fund.*

tax rate) or the tax rate must increase (to maintain constant benefit levels). Under the current pay-as-you-go financing, these are the constraints policymakers and the public face (see Figure 1).

For instance, if the worker-beneficiary ratio falls from 3.4 to 2, one of two things must happen: The average benefits must fall from 36 percent of the average worker's wage to just 25 percent, or the payroll tax rate must rise to around 18 percent of wages to maintain the 36 percent benefit rate. No amount of kind words about "sacred trusts" can change that unfortunate fact. It is not a matter of political commitment or concern for the elderly, as reform opponents charge. It is a matter of simple mathematics: Under the current system we can pay promised benefits or we can maintain current tax rates, but we cannot do both. No amount of kind words justifies promising benefits without specifying how those benefits are to be paid.

Tax and Benefit Baselines: Not Mix and Match

The above discussion shows that the current 12.4 percent payroll tax rate is mathematically incompatible with currently legislated benefit levels under today's pay-as-you-go financing. One or the other—or both—must change.

In comparing benefits paid under the commission's (or any other) reform plans with the current program's, it is very important to recognize the distinction between "promised" and "payable" benefits. Promised benefits are exactly that: what Social Security's benefit formula *promises* a worker with a given wage history. Social Security's "payable" benefit, by contrast, is what the underfunded system will in fact pay under current law. As Table 1 shows, the promised and payable benefit baselines must be matched with the appropriate tax baselines, which have been termed pay-as-you-go and current law. Pay-as-you-go is the rate required to pay promised benefits, while current law is the 12.4 percent rate currently in effect.

These tax and benefit baselines are not like a menu from which you may chose one baseline from the tax column and another from the benefit column. Each benefit baseline has only one appropriate tax baseline.

Opponents of personal accounts often violate this rule. Critics cite Social Security's promised

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benefits when making comparisons with reform proposals, which is perfectly acceptable as long as they produce a plan that can actually pay that promised level of benefits. Unfortunately, most reform opponents don't have such a plan and, when challenged by the president's commission to produce one, failed. Again, account opponents are not required to have a reform plan, as long as they're satisfied to cite only Social Security's payable level of benefits.

If the reform debate is simply going to be an exercise in promising benefits without paying for them, why not promise everyone 10 times the benefits without any question of where the money will come from? Consistency of baselines is probably the single most important thing to remember to avoid being deceived in the Social Security debate. Without a reform plan, promised benefits are just a pipe dream.

A related issue involves clarifying what "current law" benefit levels truly are. Many commentators use the phrase current law to denote promised benefits. Under the Social Security Act, taxes trump benefits. As the Concord Coalition puts it:

> All of the long-term spending projections for Social Security—by the Congressional Budget Office, the GAO, and the Social Security Administration itself—assume that current-law benefits will be paid in full, even after the trust funds are empty. This cannot happen. If Social Security is simply left on autopilot, the law leaves no doubt that the contradiction will be resolved the other way around—with massive benefit cuts. Making this fact more widely known would have two salutary consequences. In general, it would cause the public to take a more active interest in reform. And in particular, it would allow a fairer comparison of reform proposals with current law. As things stand, reformers face the hopeless task of trying to out-promise a system that is unsustainable.[8]

The Social Security Administration is authorized to issue benefit checks only when sufficient funds exist in the trust fund. Because these funds are ultimately derived from legislated payroll tax rates, under current law, when the fund becomes insolvent in 2038, taxes will remain constant while benefits for all Social Security beneficiaries (not simply new retirees) will be reduced to the level payable by payroll tax receipts.[9]

The current Social Security system's finances are driven almost entirely by tax rates, benefit levels, and the ratio of workers to retirees. Other factors, including economic growth and interest rates, play relatively minor roles. The problem is that currently legislated tax rates, when combined with the projected

Table 1
Tax and Benefit Baselines Must Match

Benefits		⟷	Taxes	
Promised	100 percent of currently scheduled benefits	⟷	Pay-as-you-go[a]	18.3 percent
Payable	72 percent of currently scheduled benefits[b]	⟷	Current law	12.4 percent

Source: 2001 Trustees Report, Table IV.B1, "Estimated Income Rates and Cost Rates, Calendar Years 2001–2075."
a. Average of years 2038–2075, ranging from 17.8 to 19.4 percent of taxable payroll.
b. Average of years 2038–2075, ranging from 74 to 69 percent of schedule benefits.

worker-retiree ratios, simply cannot equal the benefit levels promised under current law.

The Interim Report and the Trust Fund

Although much of the interim report's discussion was unremarkable, two issues in particular attracted attention—most of it unfavorable. The first was the commissioners' claim that the Social Security trust fund has not been effective in prefunding the program for the future. The fund, the commission argued, is an asset to Social Security but an equal and opposite liability to the rest of the federal government. From the point of view of the taxpayer, it changes very little.

Commissioners and staff knew that the interim report would ruffle a few feathers. Nevertheless, there was genuine surprise at the reaction to the report's argument that the Social Security trust fund has not effectively prefunded the system for the future.

Upon release of the report, the commission's view of the trust fund came under immediate attack in a paper written by Henry Aaron, Alan Blinder, Alicia Munnell, and Peter Orszag and issued by the Century Foundation and the Center on Budget and Policy Priorities:

> The commission asserts that the Social Security Trust Fund does not hold real assets. The Social Security Trust Fund, however, currently holds more than $1 trillion in Treasury securities. These assets are backed by the full faith and credit of the U.S. Government, the benchmark of security in global financial markets.[10]

Similar statements came from Rep. Bob Matsui (D-Calif.), who said, "This report falsely asserts that the Social Security system will be unable to meet its obligations because the assets held by the Trust Fund are 'not real.' To the contrary . . . because U.S. Treasury Bonds are the benchmark for security in global financial markets and to assert otherwise is to suggest that the U.S. Government will no longer honor its debt obligations."[11] For these and other assertions, Matsui said, the commission should have been disbanded.

Congressional Democrats such as House Minority Leader Richard Gephardt echoed these remarks. Gephardt claimed:

> The president's commission has published a misleading, misguided report that is one of the most skewed documents that I have seen in many, many years. . . . The assertion that Social Security is going bust in 2016 flies in the face of all reality. The facts are Social Security has enough reserves in the trust fund to last until at least 2038.[12]

As discussed below, the foregoing statements do not accurately reflect the arguments made by the commission. Moreover, the commission's arguments were in the past supported by the very critics who attacked them.

Given this controversy, it is worth outlining what the commission's interim report did and did *not* say about the trust fund.

- The commission did *not* say the trust fund's trillion dollars in government bonds are not "real," nor that they are not assets of the Social Security system.
- Moreover, the commission did not say that the government would default on the trust fund's bonds, despite what some commentators have repeatedly charged.[13] On the contrary, on p. 18 of the interim report the commissioners specifically declared that "the bonds in the Social Security Trust Fund will be honored." Nothing could be clearer than that, and the commission's own reform proposals bore out that pledge.

What the commission said about the Trust Fund is subtler than the caricature presented by reform opponents, and in retrospect the interim report could have been clearer and more comprehensive in its presentation. Whether this would have quieted the opposition is debatable, but it would at least have reduced misunderstandings among the public.

First, the commission pointed out that although the trust fund's bonds are an asset to Social Security, they are an equal and opposite debt to the rest of the government. This is not a matter of economics, but merely of accounting: an asset to Social Security must be a debt to someone, and that someone is the federal Treasury and, by extension, the taxpayer. The

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interim report illustrated this point with a number of quotations from the Clinton administration and such nonpartisan sources as the Congressional Budget Office, the Congressional Research Service and, here, the General Accounting Office:

> [Social Security] Trust Funds are not like private Trust Funds. They are simply budget accounts used to record receipts and expenditures earmarked for specific purposes. A private Trust Fund can set aside money for the future by increasing its assets. However, under current law, when the Trust Funds' receipts exceed costs, they are invested in Treasury securities and used to meet current cash needs of the government. These securities are an asset to the Trust Fund, but they are a claim on the Treasury. Any increase in assets to the Trust Funds is an equal increase in claims on the Treasury.[14]

Hence, the trust fund is indisputably not a *net* financial asset with which the government can pay Social Security benefits. That is, the fund's bonds do not put off the need for tax increases or spending cuts by a day or a dollar, because precisely the same steps must be taken to repay trust fund bonds as would be needed to pay full benefits directly via tax increases or spending cuts. After all, without a trust fund, beginning in 2016 we would have to raise taxes, borrow, or cut other spending to pay full Social Security benefits. With a trust fund, beginning in 2016 we must raise taxes, borrow, or cut other spending to repay the trust fund bonds that will pay full Social Security benefits. In terms of timing and cost, from the perspective of the overall budget—and the taxpayer—there is no substantive difference between having a trust fund and not having a trust fund.

A second point, however, is more important. The accounting identity pointed out by the commission—assets to Social Security equal debts to the government—does not mean that the trust fund did not or could not effectively prefund future benefits at the economic level. There was an economic argument in the interim report that is more important than the accounting point of view, and it addresses not what happens when trust fund bonds are redeemed in 2016 but what actually happened in the period from 1985 to today when those bonds were amassed.

In essence, the commission argued that the Social Security payroll tax surpluses seen since the mid-1980s were never "saved" in a true economic sense. Although the trust fund was "credited" with government bonds equal in size to these cash surpluses, thereby saving them in a financial or accounting sense, the cash itself was not used to reduce government borrowing or repay existing government debt. Rather than increasing government saving, these payroll tax surpluses tempted Congress to either spend more or tax less than it otherwise would have. In this case, though the trust fund was still credited with bonds, paying future Social Security benefits would still require raising future taxes. Future workers would suffer a net loss as taxes rose to repay the trust fund's bonds.

The commission's critics rejected this view as well. The authors of the Century Foundation paper, for instance, stated:

> The commission asserts that in the future, "the nation will face the same difficult choices as if there had been no Trust Fund at all." This assertion ignores the real economic contribution of the Trust Fund. The accumulation of Trust Fund reserves raises national saving, reduces the public debt and thereby reduces the annual cost of paying interest on that debt, and promotes economic growth.[15]

Along the same lines, Munnell and Weaver argue that trust fund surpluses have made unequivocal additions to national saving: "The excess payroll taxes that have been used to build up reserves in the Trust Funds have increased national saving and in recent years have helped pay down the debt. In this way, the very real sacrifice of today's workers has boosted investment and enhanced our capacity to pay future benefits."[16] How this process is thought to have worked merits some explanation.

According to this view, past payroll tax surpluses reduced government borrowing and, in several years, allowed existing government debt to be repaid. In doing so, they increased national saving, which in turn increased the amount of capital per worker, thereby increasing productivity. Because productivity lies at the root of wages, these too would increase. By the time Social Security needed to tap the trust fund, wages and national income in general would have risen by an amount greater than the tax increases needed to repay the trust fund's bonds. Hence, the trust fund could be repaid without making future workers worse off than they would have been had the entire enterprise never taken place.

In a 1989 study, Aaron, Bosworth, and Burtless conclude that trust fund financing could, in theory, succeed through precisely this mechanism:

> If national saving and domestic investment are increased by the additions to Social Security reserves, wages will rise about 7 percent more than trend growth. That increase would pay for the added pension costs generated by the rising proportion of beneficiaries in the total population. Workers active during the twenty-first century would actually enjoy a higher standard of living than in a world where the proportion of pensioners did not increase. *The central question is whether Social Security surpluses will be used to add to national saving or to finance current consumption.*[17]

Indeed that is the central question, as the commission stated directly in its interim report.

In the Century Foundation paper, however, the authors—Aaron included—overlook this central question and treat Social Security's impact on national saving as a fairly cut-and-dried affair in which, as a matter of accounting, Social Security surpluses raise saving on a dollar-for-dollar basis:

> If the non–Social Security portion of the budget had a deficit of $300 billion in a given year, and Social Security ran a $100 billion surplus, the net deficit would be $100 billion smaller—and national saving $100 billion higher—than otherwise. The only way in which Social Security surpluses would fail to increase government saving is if Congress decided to increase spending or reduce taxes in the non–Social Security part of the budget because of the surplus in Social Security.[18]

Of course, it is this last option that the commission considered to be most consistent with the historical evidence.[19] As shown below, in their more academic work the commission's critics acknowledge the very same issues the commission noted. And, by and large, these critics' own work lends support to the commission's position.

The Century Foundation authors are, of course, correct that, all other things being equal, a dollar of Social Security surpluses equals a dollar of extra saving. But, as many argued from early in the post-1983 period, all things aren't equal: rather than save surplus Social Security funds, the government could use them to hide the size of the deficit in non–Social Security federal spending. For instance, in 1995 President Clinton acknowledged,

> We clearly have been using payroll taxes for 12 years now, long before I ever came here, to minimize the size of the deficit exclusive of the payroll tax, so that from 1983 forward, previous Democratic congresses and Republican presidents made judgments that it was better and politically more palatable to tax payroll than income, even though it's a burden on working people and small businesses.[20]

Similarly, North Dakota senators Kent Conrad and Byron Dorgan wrote in 1995 that the payroll tax "is dedicated solely for working Americans' future retirement, it shouldn't be used either for balancing the operating budget or masking the size of the budget deficit." If it is used for those purposes, they warned, when needed "the retirement fund would have nothing but IOUs in it."[21] That is to say, if payroll tax surpluses are devoted to consumption rather than saving, then the overall burden on future workers is not reduced and the overall capacity of the economy to support Social Security payments is not enhanced.

Unfortunately, that is exactly what took place. In a 1989 report to Congress, the General Accounting Office stated:

> The changes to Social Security enacted in 1983 are not producing the result of lessening the burden of paying for the retirement benefits of the baby boom generation. The budgetary reality is that the payroll taxes are being used to finance the current operations of government and are masking the size of the on-budget deficit.

Although the trust fund's bonds are an asset to Social Security, they are an equal and opposite debt to the rest of the government. This is not a matter of economics, but merely of accounting.

The economic reality is that the Trust Fund reserves consisting of Treasury securities that are financing current consumption rather than productive investment are illusory. They will remain so until the rest of the government achieves approximate balance between revenues and outlays.[22]

For the record, it was only in 1999–2000 that on-budget government finances reached surplus. In 1990 testimony to Congress, the GAO's head, Comptroller General Charles A. Bowsher, said "the luxury of these reserves has provided a convenient excuse for avoiding the tough choices needed to cut the general fund deficit."[23]

In other words, the GAO found that the on-budget balance was not independent of the Social Security balance; larger surpluses in Social Security facilitated larger deficits elsewhere. In that case, Bowsher said, "The growing Social Security surpluses are serving more as a substitute for other deficit reduction action than as a net addition to national savings. . . . If we do not use the accumulating Social Security reserves to increase our national savings rate, we will be in no better position to meet our obligations to future retirees than we would be if we had remained under pay-as-you-go financing."[24]

The commission argued that Social Security payroll tax surpluses were never "saved" in a true economic sense.

Lawrence H. Thompson, the GAO's assistant comptroller general, put it most plainly: "We shouldn't kid the American people into thinking extra savings is going on."[25]

The Commission's Opponents Share Its View of the Trust Fund

Although the commission's view of the trust fund clearly has support among politicians of both parties and from the nonpartisan General Accounting Office, it is ironic that perhaps the strongest support for its view comes from the very analysts who so severely criticized the commission's interim report.

As pointed out above, it is possible—indeed plausible—that payroll tax surpluses would tempt Congress to spend more or tax less than it otherwise would. Doing so would not change Social Security's finances on paper, but would greatly alter the economic realities of paying future benefits. In the early 1980s, soon after the decision to "prefund" Social Security via trust fund surpluses was made, Munnell feared this could be the outcome:

If the payroll taxes earmarked to pay future retirement and disability benefits are used to cover current outlays from the general fund, then the government debt held by the Trust Funds will be no more than paper claims. When the baby boom generation retires after the turn of the century, the Trust Funds will redeem their claims on the Treasury in order to pay promised benefits. The Treasury, however, will not have accumulated resources to meet its obligations but rather will be forced to raise taxes at that time to pay off its debts. Thus, the full burden of supporting the beneficiaries will come from the future taxpayers—just as if the system had been financed on a pay-as-you-go basis all along.[26]

This is precisely the fear expressed by the commission.

It is, of course, difficult to know what the level of non–Social Security federal spending and taxation would have been had there been no payroll tax surpluses.[27] Nevertheless, the surprising fact was that most of those arguing against the commission's portrayal of the trust fund had in the past actually agreed with it—at least until the commission's argument was used to buttress the case for personal accounts.

For instance, while Congressman Matsui attacked the commission's depiction of the trust fund, in the past he had clearly embraced both the commission's reasoning and its conclusions. In a 1990 op-ed coauthored with Sen. Bob Graham (D-Fla.), Matsui's rhetorical attack against the fund went beyond anything stated in the interim report:

Trust Fund reserves are growing at the pace of a billion dollars a week. But these billions won't be available to the next generations of America's retirees. As quickly as the surpluses amass, they are being siphoned off to help finance the deficit. Bluntly put, the federal government is spending more than $1 billion a week of the Social Security surplus as though it were general revenues. All that the Trust Fund gets for these expenditures are chits from the U.S. Treasury. . . . If those monies are really to be there, if when we retire we are going to be left with anything more than a vault full of Treasury Department IOUs, integrity must be restored to the use of the Trust Fund surpluses.[28]

To prevent further government spending of Social Security surpluses, Matsui and Graham proposed investing those funds in nonfederal municipal bonds, though the lower rates of return on those bonds relative to the fund's current holdings would require ongoing general revenue subsidies to make up the losses. In other words, Matsui and Graham apparently believed so strongly that Social Security surpluses were being spent rather than saved that they proposed a plan that was, in financial terms, a money-loser simply to get those surpluses out of the hands of the federal government.

This aspect of Matsui's proposal is particularly interesting given Matsui's charge that a fault of reform is "plans to allow people to direct part of their payroll taxes into individual accounts make Social Security's financing problem worse, not better"[29] and "privatization proposals would only make Social Security's challenges harder to solve."[30] Of course, Social Security's actuaries state, "If the personal accounts are considered as part of 'Social Security,' it is reasonable to combine the amounts of Trust Fund assets and personal accounts for a representation of total system assets."[31] By this standard, as detailed below, the commission's three reform proposals make an immeasurable improvement over current law.

Moreover, as recently as the summer of 2000, Matsui warned his constituents, "When the Baby Boomers begin to retire in the next 10 years, Social Security will begin to pay out more in benefits than it receives in revenue,"[32] apparently giving credence to the 2016 date stressed in the interim report.

A similar warning was sounded by the coauthors of the Century Foundation paper. In 1988, for instance, Henry Aaron took a very skeptical view of the trust fund:

> The economic justification for additions to Social Security reserves is that such surpluses increase national saving, add to the U.S. capital stock, and boost productive capacity in anticipation of the extra costs a growing population of retirees will generate. *Current budget policy overwhelms this sound policy. Instead of adding to U.S. national saving, current fiscal policy simply diverts a part of payroll taxes to pay for ordinary operations of government.*[33]

It's worth pointing out that the budget policy Aaron was decrying in 1988 is the same budget policy that, with brief exceptions, has held every year since 1985.

Moreover, in 1988, Aaron, Bosworth, and Burtless clearly rejected the idea that it was being effectively carried out:

> If OASDHI [Old Age, Survivors, Disability and Hospital Insurance] revenues exceed annual expenditures, the resulting surpluses may be used to pay for current public or private consumption (either through increases in non-OASDHI government expenditures or through reductions in non-OASDHI taxes). As the OASDHI surpluses increase, so would deficits elsewhere in the federal budget. *Although this policy may seem peculiar, it closely resembles the course on which the United States is embarked today. Under this policy, the reserve does not add to national saving (because it does not reduce the overall government budget deficit) and, hence, it does not add to future productive capacity.* In effect, the OASDHI surpluses are borrowed to pay for current government services, replacing income tax revenues or cuts in other government programs sufficient to balance the non-OASDHI budget.
>
> Although such a policy might hold down future payroll tax rates, it cannot protect future taxpayers from shouldering the expense of rising benefit costs. When and if the Trust Funds are drawn down to pay for future benefits, other federal taxes will have to be increased to finance the repurchase of government debt previously bought by the OASDHI Trust Funds. In addition, the incomes against which those taxes are imposed will be no larger than if the reserves never existed. Since future benefits must be paid out of future production, the burden on future taxpayers would not be reduced.

The authors concluded:

Rather than save surplus Social Security funds, the government could use them to hide the size of the deficit in non–Social Security federal spending.

> The growing surpluses in the Social Security system camouflage a major deterioration in the budget balance for non-OASDHI operations. . . . In effect, the current policy is to borrow the OASDHI surplus to finance a deficit in the rest of the budget. As a result the payroll tax, ostensibly earmarked for retirement, survivors, disability, and hospital insurance, is being used increasingly to pay for other government expenditures, such as defense and interest on the public debt.[34]

Aaron has not, to the author's knowledge, explained whether or why he changed his view. It is arguable that trust fund surpluses were at least partially saved during the years of on-budget surpluses in 1999–2000, yet Aaron appears to have changed his mind about what took place *before* those years as well, without providing evidence as to why.

Larger surpluses in Social Security facilitated larger deficits elsewhere.

Alicia Munnell expressed similar skepticism toward trust fund financing in the 1980s on the basis of evidence from other countries that attempted trust fund financing and the factors that influenced their success or failure. Three factors that reduce the prospects for successful trust fund financing:

- Whether the pension fund's surpluses are considered part of a unified budget.
- Whether the fund can invest in private securities or is a "captive market" of the Treasury.
- Whether the government fluctuated political control from party to party.

As Munnell noted, all of these criteria apply to the United States:

> One factor in this regard is probably whether the Social Security programs are included in some type of unified budget or are accounted for separately. If Trust Fund activity is integrated with other federal functions and the total reported as a single figure, as has been true in the United States since 1969, Congress and the public would be encouraged to think that the Trust Fund reserves are available to cover general government outlays.
>
> Another closely related factor is the ease with which the Treasury can borrow from the Trust Funds. This depends on the extent to which the administration and the finances of the Social Security Trust Funds and the rest of the government are intertwined.

In addition, Munnell argued, the use of a "unified budget" concept in the United States tends to blend Social Security and non–Social Security funds in the eyes of lawmakers:

> In the United States the finances of the Social Security Trust Funds and the rest of the budget are closely intermingled. The Treasury Department, rather than the Social Security Administration, collects the earmarked payroll taxes and deposits them in a general account with other revenues it receives. The Trust Funds are then issued with special federal securities in a compensating amount. While the balances of the securities reflect the resources available to the Social Security programs, they more closely resemble spending limitations than control over resources. One would expect less use of Trust Fund revenues for general government expenditures in situations where the Trust Funds are more than a bookkeeping activity on the part of the Treasury Department.

Munnell goes on to point out:

> The likelihood of the members of Congress responding to the Social Security surpluses in this manner probably depends largely on their ability to count the surpluses toward overall budget deficit reduction. All three countries studied keep their Social Security accounts very separate from the rest of the budget, and this appears to have discouraged the legislatures from incorporating Social Security surpluses in their general budget decisions or their deficit reduction efforts. As long as the United States retains a unified budget and frames its deficit targets in these terms, Congress will be tempted to keep one eye on the surpluses when voting on tax and expenditure proposals.
>
> A somewhat discouraging result, for those committed to increasing national

> saving through accumulating reserves in the Social Security Trust Funds, is that the greatest success has occurred in countries with stable and disciplined political environments, where one party has been in power almost continuously since the experiment began.[35]

For these reasons, soon after the 1983 reforms Munnell argued against running Social Security surpluses at all.

With her co-author Lynn Blais, now of the University of Texas School of Law, Munnell elaborated:

> The assumption that an increase in Trust Fund reserves will represent a net increment to national saving may not be valid. Instead, surpluses in the Social Security Trust Funds may very likely be offset by deficits in the rest of the budget, so that they are, in effect, used to finance general government expenditures. Indeed, the pattern shown in Table 2 [showing Social Security and general budget balance from 1946–1983] indicates that this may have been the case in the past. Of course, these figures are far from conclusive because it is difficult to determine what the balance would have been in the federal budget without the surpluses in the Social Security Trust Funds. *Nevertheless, our best guess is that the scheduled buildup of assets in the Social Security Trust Funds over the next 35 years would be used to offset deficits elsewhere in the federal budget and thus would contribute little to overall saving and capital accumulation.*
>
> In this country it appears it would be difficult as a practical matter to stockpile real resources in anticipation of future benefit payments. It is more likely that Congress would divert surpluses in the Trust Fund to offset deficits in other parts of the federal budget.

Munnell and Blais concluded at the time that it would be preferable to abandon efforts to prefund Social Security through the trust fund financing mechanism:

> In view of the improbability that Social Security surpluses will increase national saving and the possibility that, if increased saving did materialize, it would have adverse fiscal implications or disrupt financial markets, the authors conclude that it would be preferable to return the Social Security system to pay-as-you-go financing with a substantial contingency reserve.[36]

Incidentally, Senator Moynihan took the same view when, in 1989–90, he argued that if Social Security surpluses were not truly being saved, the system's finances should return to a pay-as-you-go basis. "We cannot continue to use regressive payroll taxes to finance general government expenses. This is not acceptable," he said.[37]

Alan Blinder of Princeton University has written less on Social Security trust fund surpluses and national saving than Aaron or Munnell. Nevertheless, in a 1990 commentary on a paper by Nobel laureate James Buchanan in which Buchanan argues that "a small dose of public

Although Social Security surpluses have clearly funded the system in a narrow sense, in the broader sense of raising national saving, they have fallen short.

Table 2
Personal Account Plans Would Maintain or Enhance System Progressivity

	Current Law	Plan 1	Plan 2	Plan 3
Benefit to low-wage retiree	$767	$770	$868	$823
Benefit to high-wage retiree	$1,673	$1,684	$1,556	$1,646
Low as percentage of high	46%	46%	56%	50%

Source: Derived from Stephen C. Goss and Alice H. Wade "Estimates of Financial Effects for Three Models Developed by the President's Commission to Strengthen Social Security," Memorandum dated January 31, 2002, pp.74–76. Based on workers retiring in 2022 and holding the default investment portfolio.

If Social Security surpluses were saved as a matter of course, any lock-box would be redundant.

choice theory might have dampened the enthusiasm of those who sought to ensure the integrity of the system" by running Social Security surpluses within the context of the overall budget,[38] Blinder stated his agreement with Buchanan on this point: "Buchanan asserts that the Social Security surpluses of the next thirty years or so will make the government prone to do more non-Social Security spending than it otherwise would have done. As I have already made clear, I suspect he is right."[39]

Peter Orszag of the Brookings Institution, another author of the Century Foundation paper, has also written less in the past on the impact of trust fund accumulations on national saving. Nevertheless, in recent Congressional testimony Orszag implicitly acknowledges that past surpluses may not have contributed to national saving in the dollar-for-dollar manner outlined in the Center on Budget and Policy Priorities paper. Orszag argues, in much the same way as the commission, that it is important to

> distinguish between "narrow" and "broad" prefunding. In its narrow sense, prefunding means that the pension system is accumulating assets against future projected payments. In a broader sense, however, prefunding means increasing national saving. The broader definition of prefunding—higher national saving—should be our ultimate objective. But we can sometimes be led astray, because prefunding in the narrow sense need not imply prefunding in the broader sense (i.e., higher national saving).[40]

Orszag points out, correctly, that both trust fund and personal account financing could create narrow, but not broad, prefunding if extra saving through the pension system were offset by lack of saving elsewhere. Individuals could reduce contributions to non-Social Security investment accounts or the government could increase spending or lower taxes elsewhere in the budget. This is precisely the distinction made in the commission's interim report: although Social Security surpluses have clearly funded the system in a narrow sense, in the broader sense of raising national saving, they have fallen short.

Orszag follows the above passage with the statement that "the emerging political consensus not to spend the Social Security and Medicare surpluses is *precisely what ensures that the narrow prefunding in the Trust Funds also corresponds to higher national saving* (i.e., broad prefunding)."[41]

But if a lock-box is needed to ensure that Social Security surpluses translate into increased national saving, then we can assume that when the lock-box budget mechanism was absent—from 1983 through 1999—increased saving is less likely to have occurred. Viewed another way, if Social Security surpluses were saved as a matter of course, as Orszag and the other authors of the CBPP paper maintain, any lock-box would be redundant. Orszag's comments appear to acknowledge this. Moreover, although lock-boxing future Social Security surpluses may raise national saving, it cannot change the fact that past surpluses were not treated in this way.

Other Congressional leaders held similar views of the efficacy of the Trust Fund. In 1989 Rep. Richard Gephardt (D-Mo.) argued that the government "should stop borrowing on workers' retirement benefits. People should be secure in the knowledge that the system will be able to send out their monthly Social Security checks. If the practice of borrowing against Social Security monies continues, that security is threatened."[42] In 1990, Gephardt said, "What Democrats want to do is we want to stop the stealing of [trust] funds to mask the deficit." According to the article, Gephardt said, "The government would have to pay interest on the borrowed money. To pay back Social Security by 2015 or 2018, taxes would have to increase."[43] That is precisely the point the commission's interim report made. It should now be clear that most of the commission's most prominent critics agreed with it.

As an aside, many commentators who have criticized the tax cuts passed by Congress in 2001 as weakening Social Security simultaneously take the view that Social Security's trust fund is "real" regardless of whether accompanying payroll tax surpluses are spent or saved. But the bookkeeping balance of Social Security's trust fund is unaffected by the balance of the non-Social Security budget; whether the tax cut was passed or not, Social Security would be credited with the same amount of bonds. Critics are free to argue that funds sent back to the public in last year's tax cut could have been better used by saving them for Social Security.[44] If that is the case, though, those critics must also accept the commission's logic that the "raids" on the trust fund that took place practically every year from 1985 to the present must have weakened Social Security far more because these prior "raids" were used to finance additional government spending. There is at least a theoretical argument that the recent tax cuts will stimulate long-term economic growth. In their responses to the commission's interim report, account opponents failed to reconcile their short-term arguments against tax cuts with their longer-term defense of the current trust fund financing structure.

Now, one might ask, "Why do these arguments about the trust fund even matter?" In one sense, they don't: the assets we have are the assets we have, and nothing we do today can change the past. This was the point of the commission's accounting argument: as benefit costs begin to rise, there is no separate store of wealth with which to pay them. Looking forward, though, the trust fund issue is extremely important. If we conclude that trust fund financing doesn't truly reduce burdens on future taxpayers, we have only three other options:

- Return to pay-as-you-go financing.
- Have the government invest the trust fund in the private assets.
- Invest individually through personal accounts.

Few wish to return to pay-as-you-go financing, which entails a 50 percent increase in payroll tax rates to meet current benefit promises. And, politically speaking, a battle between government investment and personal accounts would be a rout. The economics may be the same, but the politics are worlds apart: the public simply doesn't trust the government to invest in private corporations, and even after two years of weak market performances public support for personal accounts remains strong.[45]

What made the trust fund controversy surprising was that the very people who most prominently disagreed with the commission's view last summer had prominently agreed with it before—before, that is, it was used to support the case for personal accounts.

Progressivity

The second point of controversy in the interim report was the commission's contention that the current Social Security system isn't nearly as progressive as many of its proponents claim. If Social Security's progressivity is called into doubt, the transition to personal accounts—which are often designed with less explicit regard to progressivity—would not significantly alter the distribution of costs and benefits to the system as a whole.

This idea, like the commission's views on the trust fund, came under attack. For instance, Peter Coy of *Business Week* wrote:

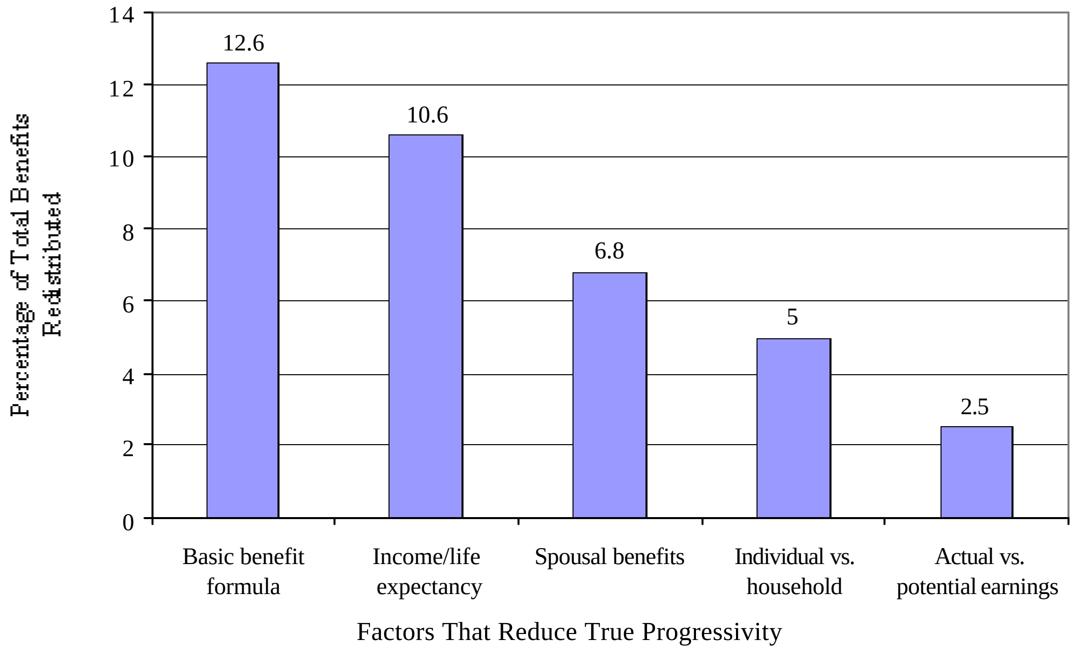
> Today's Social Security is progressive—that is, it transfers money from rich to poor in large part because of the benefits formula. The higher your average lifetime income, the less of it is replaced by your benefit check in retirement. That Robin Hood formula largely offsets the fact that low-income people tend to collect fewer checks because they die younger. "Privatizing Social Security may have some merits," Coy said, "but the argument that it would benefit the poor is deeply flawed."[46]

In fact, the academic research that Coy relied on in his critique of private accounts shows clearly how little Social Security's so-called Robin Hood benefit formula actually takes from the rich and gives to the poor. Social Security's complex benefit formula does a great deal of redistribution on the basis of longevity, marital status, and the relative wages of spouses, but very little on the basis of income. Personal account reform proposals—even proposals with no redistributive intent—would leave system progressivity largely unchanged. In fact, the commission's personal account plans are consciously progressive, and enhance benefits for low-wage workers, as discussed below.

Research on redistribution in Social Security is complex and ongoing, and ranges from the construction of models of representative workers to the statistical analysis of large numbers of actual earnings records. The following summary relies on a recent study by Alan Gustman of Dartmouth College and Thomas Steinmeier of Texas Tech, who used Social Security earnings records contained in the National Institute on Aging's Health and Retirement Study to disaggregate the various factors influencing Social Security's overall progressivity.[47] Although

Although lock-boxing future Social Security surpluses may raise national saving, it cannot change the fact that past surpluses were not treated in this way.

Figure 2
Actual Social Security Redistribution Is One-Fifth of What Basic Benefit Formula Implies



Source: Alan Gustman and Thomas Steinmeier, "How Effective Is Redistribution under the Social Security Benefit Formula?" *Journal of Public Economics* 82, no. 1 (October 2001): 1–28.

Account opponents failed to reconcile their short-term arguments against tax cuts with their longer-term defense of the current trust fund financing structure.

details differ among researchers, the Gustman and Steinmeier article is representative of the general direction in which academic research on Social Security's progressivity is flowing. Some other research finds even less progressivity in the current program.[48] Nevertheless, the Gustman and Steinmeier article is reasonably representative of current research.

On its face, Social Security is highly redistributive because its progressive benefit formula replaces a substantially higher portion of a low-income worker's preretirement earnings than of that a high-income worker. On the basis of the benefit formula alone, Gustman and Steinmeier find that Social Security should redistribute 12.6 percent of total benefits from higher to lower-income workers (see Figure 2). This would be sufficient to substantially increase the benefits for low-wage retirees.

But Gustman and Steinmeier find four major factors that substantially reduce Social Security's true progressivity.

First, the correlation between income and life expectancy means that, while low-income retirees may receive relatively higher monthly benefits, total lifetime benefits are not nearly so progressive. Once differential mortality is factored into the equation, net progressivity is reduced by 16 percent, leaving 10.6 percent of total benefits redistributed.

The influence of differential mortality on Social Security's progressivity could increase in the future. Although life expectancies for all Americans are increasing, there is evidence that they are increasing more slowly for individuals with lower wages and educations. If that is the case, Social Security could become even less progressive in this regard.[49]

A second factor is that Social Security pays spousal benefits. The spouses of high earners on average live longer and receive higher benefits than the spouses of lower earners, reducing progressivity by another 30 percent. This leaves 6.8 percent of total benefits redistributed.

Although Gustman and Steinmeier make no projections regarding the future, this issue could be complicated in coming years. On the one hand, as more women have entered the workforce and gained benefit eligibility on the basis of their own earnings, the spousal benefit may play a smaller role in the future than it does today. On the other hand, the spousal benefit could increase disparities in benefits between individuals of different races, as the "marriage gap" between blacks and whites has widened in recent decades. In 1960, some 67 percent of white females aged 15 and over were married, versus 57 percent of black females. In 1998, however, although the percentage of white married females had dropped to 58 percent, for black females it had fallen to 36 percent, making most black females ineligible for spousal benefits at retirement.[50]

A third factor that reduces Social Security's progressivity is that much of the program's apparent redistribution is from the richer to the poorer spouse *living in the same household,* rather than from an upper-income household to a lower-income household. In other words, when benefits are redistributed from husband to wife, there is no effect on household progressivity. Because spouses share income and expenses, the household is the more relevant standard for public policy purposes. From that perspective, Social Security's progressivity is reduced another 14 percent, leaving 5 percent of total benefits redistributed.

Finally, although many individuals with low lifetime incomes have worked full careers at low wages, many others are *high*-income workers who took time out of the workforce.[51] In fact, Gustman and Steinmeier found that most of the individuals with the lowest lifetime earnings were women with total household incomes far above what could be expected on the basis of their own earnings. That is to say, having a high-income spouse enabled some of these women to have lower incomes themselves. Adjusted for potential lifetime earnings—earnings if individuals worked a full career—Social Security's total progressivity is reduced by another 20 percent, so that just 2.5 percent of total benefits are redistributed.

To sum up, Social Security's true progressivity is just one-fifth of what it seems to be on the surface. For that reason, Gustman and Steinmeier state:

> It is clear from these results that the general perception that a great deal of redistribution from the rich to the poor is accomplished by the progressive Social Security benefit formula is greatly exaggerated. As a result, adoption of a Social Security scheme with individual accounts designed to be neutral with regard to redistribution would make much less difference to the distribution of Social Security benefits and taxes among families with different earnings capacities than is commonly believed.[52]

In fact, the plans adopted by the commission included personal accounts, but these accounts were not neutral with regard to progressivity and made Social Security a better deal for the poor and for other vulnerable members of society. Although Peter Coy argued that "attempts to insulate the poor from the regressive features of a privatized Social Security system would require so many awkward compromises that it might leave no one happy," the commission's plans enhanced progressivity in ways that would be seamless from the point of view of the individual and the administrators of the program.

Moreover, though Coy acknowledged that aspects of the commission's proposals would at the least maintain system progressivity—such as the progressive funding of the accounts themselves, in Plans 2 and 3—he argued that such provisions might not "survive the budgeters' axe" to be enacted.[53] But this objection can be applied to any reform proposal, as well as to current law, because Congress changes laws as it wills. Coy's is simply not an intellectually respectable objection to the commission's progressive reform plans, which were designed from the bottom up with progressivity in mind. The commission's plans without their provisions to enhance retirement security and wealth building for the least advantaged Americans are simply not the commission's plans; to pretend otherwise is to portray a caricature of the commission's proposals.

In addition, Coy argued, "It's not clear, however, that those offsets alone, even if they survived the budgeters' ax, would leave Social Security as progressive as it is today." Although comprehensive measures of progressivity are complex, an easy shorthand measure is simply to compare benefits received by low-wage retirees with those received by high-wage retirees.

As Table 2 shows (see p. 13), under current law, a low-wage retiree in 2022 would receive benefits equal to 46 percent of those received by a high-wage retiree.[54] Under Plan 1, the current

Few wish to return to pay-as-you-go financing, which entails a 50 percent increase in payroll tax rates to meet current benefit promises.

Even after two years of weak market performances public support for personal accounts remains strong.

46 percent progressivity ratio would be maintained, while under Plan 2 it would increase substantially to 56 percent, and under Plan 3 to 50 percent. It is worth noting that although Plan 1 would not enhance progressivity per se, benefits would be higher for all recipients.

Some critics argue, of course, that although Social Security's retirement and survivors programs may not be progressive, its disability program disproportionately benefits the poor, thereby making up the difference. The commission noted in its interim report that the poor and minorities are more likely to receive Social Security's disability payments.[55] But even when disability benefits are counted, a low-income single male still receives a lower return from Social Security than does a high-income single-earner couple, according to Social Security's actuaries.[56] Moreover, changes to Social Security's retirement program, such as personal accounts, need not reduce the progressivity of the disability program. Although the commission's treatment of disability provisions is discussed at greater length below, under the commission's plans the special provisions for low-wage workers apply to their disability as well as their retirement benefits, so disabled workers would not be disadvantaged relative to higher wage earners.

The Commission's Reform Plans—Common Characteristics

In its report to the president in December, the commission outlined three reform proposals. Although they all contain personal accounts, beyond that they cover a spectrum of reform options. Nonetheless, the plans have a number of features in common.

Optional Personal Accounts

Under all three models, workers would have the option to invest part of their payroll taxes in a personal retirement account. Note that these personal accounts would be voluntary. No worker would be forced to take an account, and no worker with an account would be forced to invest in the stock market. Workers seeking extra security could invest solely in government or corporate bonds.

For simplicity's sake, Social Security's actuaries estimate personal account benefits under three stylized portfolios:

1. The standard portfolio is assumed to consist of 50 percent stocks (with an annual rate of return of 6.5 percent after inflation); 30 percent corporate bonds (3.5 percent annual return); and 20 percent government bonds (3.0 percent annual return). Assuming administrative costs of 0.3 percent of assets managed, the net annual return is assumed to be 4.6 percent after inflation.
2. The low-yield portfolio is assumed to hold only government bonds, with a yield, net of administrative costs, of 2.7 percent annually.
3. The high-yield portfolio assumes that 60 percent of the portfolio is invested in equities or, alternately, that the equities held in the default portfolio return the historical average of 7.1 percent after inflation rather than the assumed return of 6.5 percent.

Analysis of the three reform plans produced by Social Security's actuaries assumes that a worker holds a particular portfolio throughout his working lifetime. More realistically, workers would likely adjust their portfolios as they age, beginning with greater stock allocations and moving toward fixed income investments as they near retirement. Most workers aged 60 to 65 hold approximately 40 percent of their 401(k) account portfolios in equities.[57] Asset allocations could be expected to differ somewhat with personal accounts for Social Security, but the trend from equities to fixed income investments over the course of the life cycle should be expected to continue.

Under all three commission plans the personal accounts would be the property of the worker: The government could not "raid" it to pay for other programs, and it could be passed on to the worker's heirs in case of premature death. The ownership aspect of personal accounts is of particular benefit to African American males, one-third of whom do not survive to age 65.

Common Administrative Structure

All three plans would use a centralized and simplified administrative structure similar to that of the federal Thrift Savings Plan, which would keep administrative costs to just 0.3 percent of assets managed while simplifying account management for first-time investors. Account holders would choose from a range of simplified index funds; no individual stocks or sector funds (such as the NASDAQ) could be chosen, which would ensure adequate diversification for long-term investment purposes.

Cost of Living Adjustments (COLAs) Maintained

All three proposals would maintain annual adjustments to traditional benefits to maintain purchasing power in the face of inflation. In addition, the actuaries' analysis assumes that, at retirement, workers would convert their entire accounts into fixed or variable annuities, though the commission made no formal recommendation that workers be required to do so.[58] Benefit numbers cited herein assume conversion to a fixed annuity that pays constant benefits for life, adjusted annually for inflation. Workers who chose variable annuities would receive benefits 4 to 9 percent higher than those with fixed annuities, assuming that the annuities are invested in the default portfolio of 50 percent stocks, 50 percent bonds.[59]

Offset Interest Rate

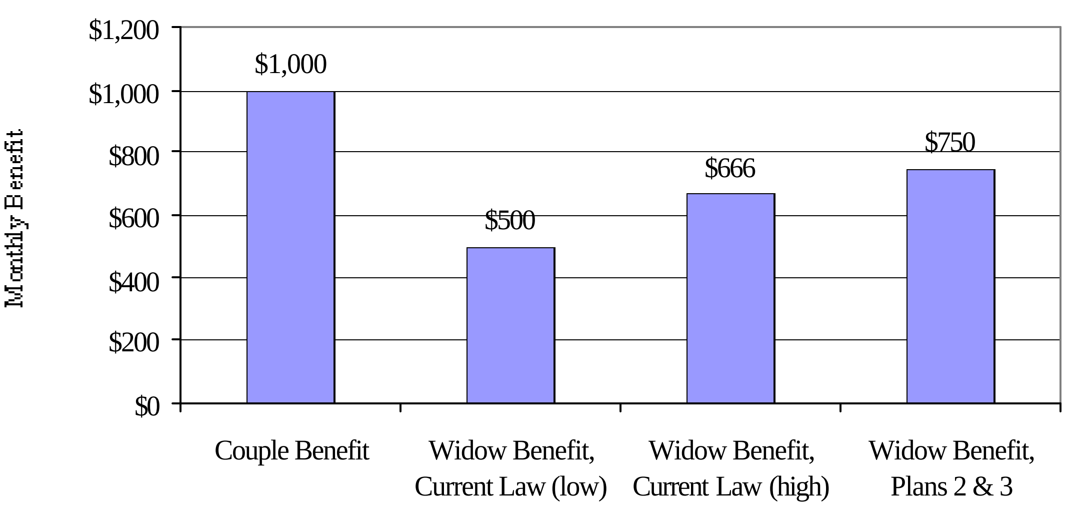
A worker choosing to invest part of his payroll taxes in a personal account accepts an offset to his traditional Social Security benefits equal to the amount of his account contributions compounded at the designated offset interest rate (3.5 percent, 2 percent, and 2.5 percent for Plans 1, 2, and 3, respectively). As long as a worker's account interest rate exceeds the offset interest rate, the worker will be assured of receiving higher total benefits by taking the account. In two of the three plans, a worker would receive higher total benefits simply by investing in government bonds, which are assumed to return 3 percent after inflation. This offset is applied up-front, at the time contributions are made to the account, and simply represents the decision to invest those contributions in the account (instead of investing them in the traditional system and earning an assumed interest rate of 3.5, 2, or 2.5 percent). There is no diminution of personal account balances at the point of retirement as a consequence of the offset.[60]

Minimum Benefit

Plans 2 and 3 incorporate new minimum benefit guarantees, such that by 2018 a minimum

Much of the program's apparent redistribution is from the richer to the poorer spouse *living in the same household,* rather than from an upper-income household to a lower-income household.

Figure 3
Lower-Income Survivors Benefit Increased from 32 to 50 Percent Compared with Current Law



Source: President's Commission to Strengthen Social Security, final report, p. 107.

No worker would be forced to take an account, and no worker with an account would be forced to invest in the stock market.

wage worker would be assured of a benefit equal to 120 percent of the poverty line in Plan 2, or 100 percent of the poverty line in Plan 3. Under Plan 2, the minimum benefit would rise annually with inflation. Under Plan 3, the minimum benefit, while initially lower than under Plan 2, would rise at the faster rate of wage growth. One-half million to one million seniors could be lifted out of poverty by virtue of these new protections, according to Social Security's actuaries.

Increased Survivors Benefit

Plans 2 and 3 also increase survivors benefits to 75 percent of the couple's prior benefit, for below average-income widow(er)s (see Figure 3). For a couple with equal incomes, this would mean a 50 percent increase in benefits to the widow. An estimated 2 to 3 million widows would receive increased benefits as a result of this new provision.

Assets Split in Divorce

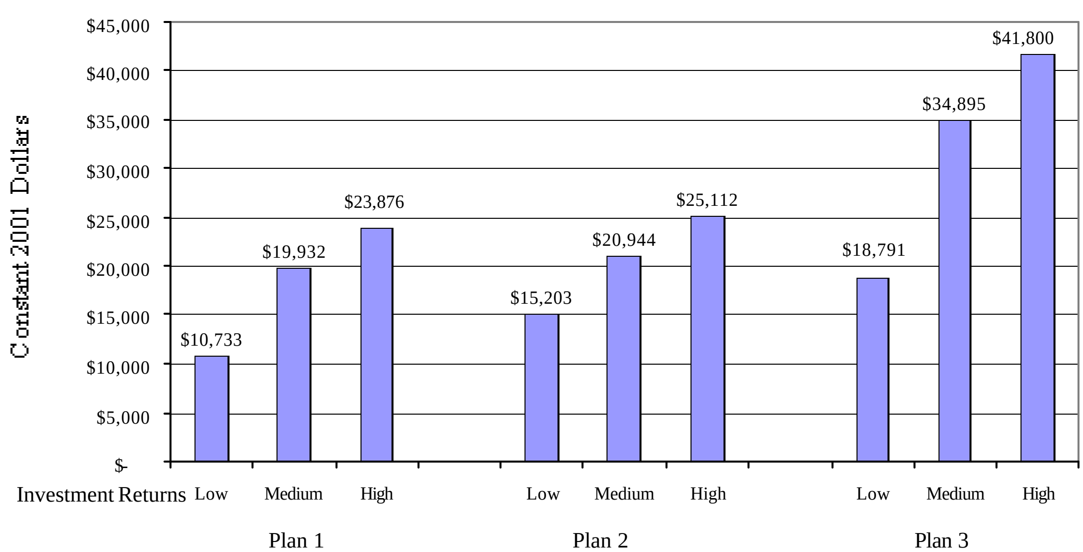
All three plans dictate that account assets be split in the event of divorce (see Figure 4). Under current law, before 10 years of marriage a spouse is not eligible to receive any benefits on the basis of the husband's or wife's earnings. Under the reform plans, that spouse would receive half the husband's or wife's account assets. These assets, if simply left to accumulate until retirement, could result in lump sums ranging from $10,000 to $40,000 for the spouse of an average-wage worker. At retirement, the account could increase the spouse's monthly income by $55 to $215. Given that women divorced at an early age are among those most vulnerable to poverty in retirement, this provision could assist a particularly vulnerable group.

Commission Plan 1

Plan 1 was designed as a flexible framework to demonstrate the power of personal accounts, absent any other considerations. In other words, it is an "accounts only" plan that does nothing to the current Social Security program other than to give workers the opportunity to invest through personal retirement accounts. This is both its strength and its weakness. On the one hand, Plan 1 shows the power of personal retirement accounts to increase Social Security's financial rate of return and to give workers the rewards of personal asset accumulation. Moreover, a number of different account options could be integrated into Plan 1's basic framework.

On the other hand, Plan 1 makes no attempt to address larger system-solvency issues. And

Figure 4
Lump Sums Available at Age 67 to Spouse of Average Earner Divorced after 10 Years



Source: Author's calculations. Assumes marriage at age 25 to average earner, no account contributions during marriage, and divorce just before 10 years of marriage. Account assets split at divorce and compounded until age 67.

although solvency is by no means the only criterion of a successful reform proposal, it is a very important one. Plan 1, while bringing Social Security marginally closer to solvency and long-term sustainability, does not go nearly far enough to satisfy that important criterion.

Plan 1 includes an optional account into which workers could invest 2 percentage points of their taxable wages. As the commissioners noted, Plan 1 presents a flexible framework:

> The accounts could be made larger, or smaller. They could be funded in a progressive fashion (with a higher contribution rate based on the first dollars of earnings than on higher earnings amounts). Some have proposed that such accounts be supplemented with extra contributions for younger workers or that such accounts be funded from general revenues. . . . Others have suggested that the accounts be made larger, with the requirement that a certain amount be invested in federal securities as a means of limiting the total size of the transition investment. Though the plan scored here envisions a 2 percent account for all wage earners, any of the above variations could be fit within this framework.[61]

As a flexible structure, Plan 1 leaves open the possibility of the account being funded as an "add-on" with general revenues rather than a "carve-out" with payroll taxes.

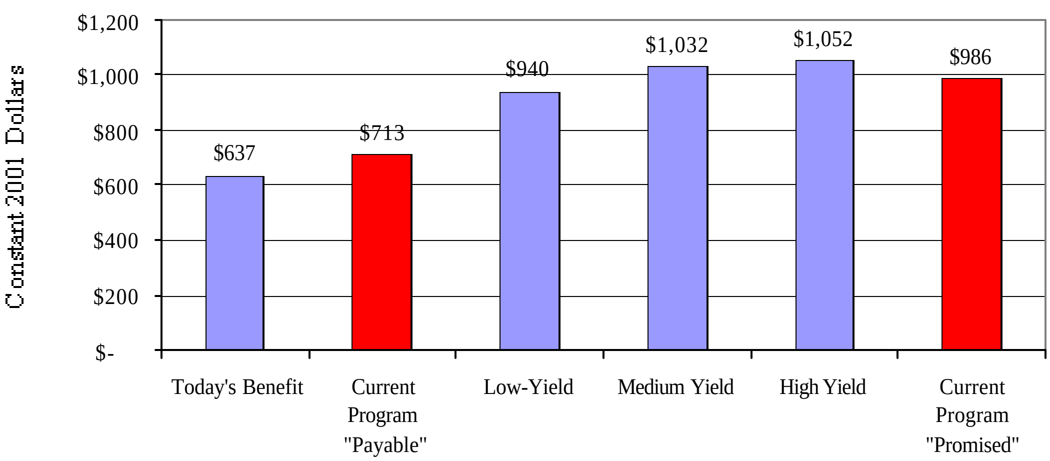
In exchange for the personal account, individuals would accept an offset to their traditional benefits at an interest rate of 3.5 percent. This offset rate, being higher than the bond rate, means that account-holders must accept some minimal risk to receive higher expected benefits than under the traditional system.

Under Plan 1, a low-wage married worker retiring in 2052 could expect total benefits some 5 percent higher than the current system promises (see Figure 5). I use such a worker to illustrate benefit levels under all three commission reform models because low-wage workers illustrate the special protections built into Plans 2 and 3. Because opponents of personal accounts claim that the poorest would be left behind, it is useful to show that this is not necessarily so. As a note, single workers would receive benefits approximately 10 percent higher from their accounts, as they would not be required to purchase joint-and-survivors annuities providing spousal coverage.

In financing terms, Plan 1 is clearly a mixed bag. If funded as a "carve-out," Plan 1 increases Social Security's 75-year actuarial deficit by 0.32 percent of payroll, so in theory it makes the system "worse off" over the measurement

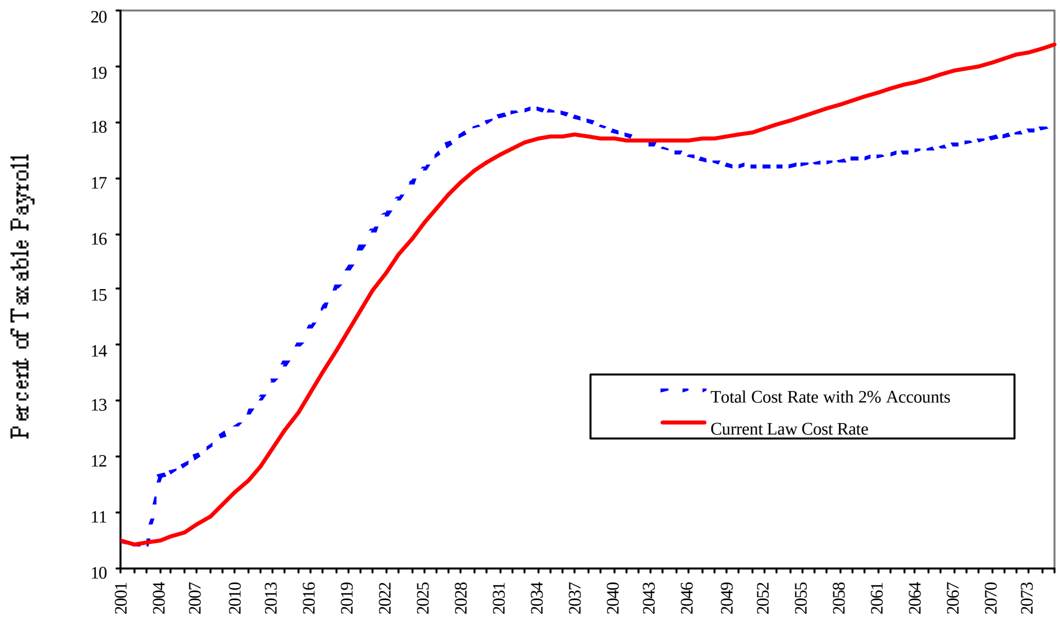
Under all three commission plans the personal accounts would be the property of the worker: The government could not "raid" it to pay for other programs, and it could be passed on to the worker's heirs in case of premature death.

Figure 5
Monthly Benefits for Low-Wage Retiree under Plan 1



Source: Stephen C. Goss and Alice H. Wade, "Estimates of Financial Effects for Three Models Developed by the President's Commission to Strengthen Social Security," Memorandum dated January 31, 2002, p.74

Figure 6
Cost of Plan 1 Compared with Cost of Current System



Source: President's Commission on Strengthening Social Security, final report, p. 115.

All three plans dictate that account assets be split in the event of divorce.

period. However, this actuarial decline is purely a function of timing. In the early years, account contributions are counted as lost income and it is only when workers with accounts actually retire that the account offset reduces liabilities to the traditional system and thereby results in cost savings. If funded as an "add-on," the general revenue requirements would be identical.

Moreover, by the year 2042, Plan 1 would be cheaper than the current system and would remain cheaper thereafter, while paying higher expected benefits to all retirees (see Figure 6). Social Security would still be running annual payroll tax deficits as of 2075, which merely shows that a 2 percent account is not enough to fix the current program, but these deficits would be 24 percent smaller than under the current system.[62] More comprehensive measures of the three plans' financing are available in the appendices.

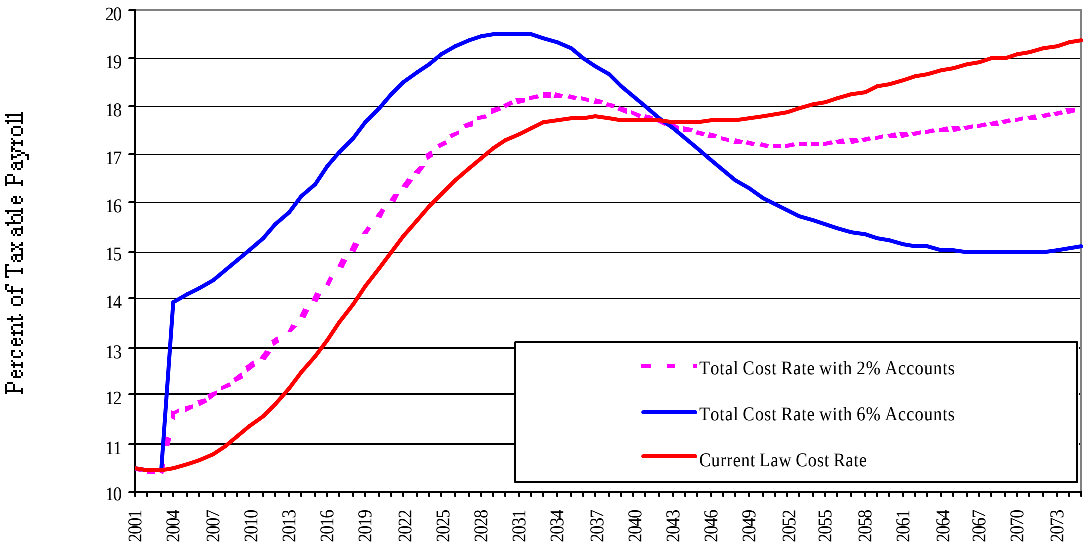
For those who argued that personal accounts by themselves hurt Social Security rather than help it, Plan 1 comes as a surprise.[63] It reduces the size of general revenue infusions needed to pay full benefits by 8 percent, versus the current program, while paying higher benefits to all retirees, and by 2042 its costs are permanently lower than those of the current system.

Since Plan 1 is by design a flexible framework, Figure 7 shows the impact of a larger account funded with 6 percent of payroll, compared with the 2 percent account of Plan 2 and the current law. The results are exactly as would be expected: the up-front costs are larger, as the government must fund the larger personal accounts while simultaneously maintaining benefits to current retirees, but once the program "turns the corner" the savings are greater as well. Moreover, total expected benefits for workers would also be proportionately higher.

In short, Plan 1 has the following characteristics:

- Workers may voluntarily invest 2 percent of their taxable wages in personal accounts.
- Traditional Social Security benefits are offset by the worker's personal account contributions compounded at an interest rate of 3.5 percent above inflation.
- No other changes are made to traditional Social Security.

Figure 7
Plan 1 Using 6% Accounts versus 2% Accounts Compared with Current Program



Source: Author's calculations.

- All retirees could expect higher benefits than under the current program.
- Beginning in 2042, Plan 1 would cost less than the current program.
- Additional revenues would be needed to keep the trust fund solvent beginning in the 2030s.
- Although Social Security's finances would be improved, the program would still not be sustainable over the long term.

Commission Plan 2

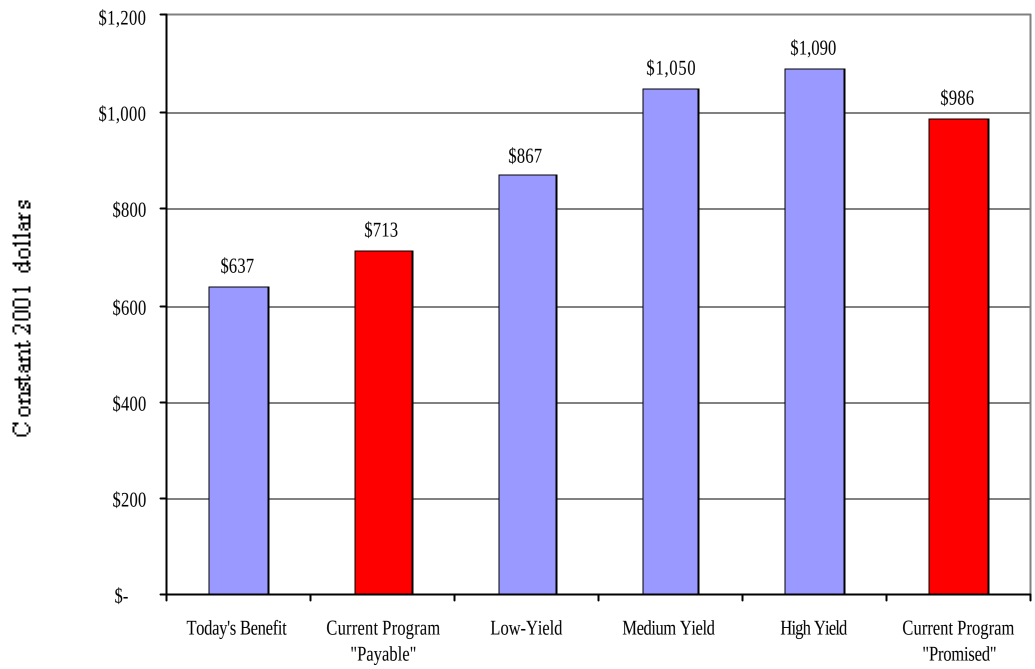
Broadly speaking, the commission's Plan 2 reflects the outlook that Social Security should maintain a real inflation-adjusted foundation on which other retirement savings could build, but that this foundation should not grow at a rate unsustainable under current payroll tax rates. In other words, it considers the adequacy of the real, inflation-adjusted resources provided to retirees more important than other considerations, particularly income replacement rates. This point of view generated controversy, but it has attracted much support in the past, even from account opponents. Plan 2 was preferred by the most of the commissioners and would be, from my point of view, the preferred direction for Social Security reform.

In Plan 2 the commission analyzed the rate of benefit growth the current program can sustain without raising taxes, regardless of whether personal accounts are introduced. This affordable rate of benefit growth is slightly faster than the rate of inflation. Plan 2, then, ensures that benefits for all workers at least keep pace with inflation and, for lower wage workers, rise at a faster rate. It is important to understand that Plan 2 incorporates Social Security's affordable rate of benefit growth, whether or not personal accounts are integrated into the program. Hence, steps taken in Plan 2 to restrain benefit growth to affordable levels are not due to the introduction of personal accounts but to the inherent fiscal constraints faced by the current program. Personal accounts in Plan 2 are not a source of the program's fiscal limitations but are introduced to overcome the current program's inherent fiscal limitations and allow the payment of total retirement benefits substantially higher than the current pay-as-you-go system is capable of paying.

The commission's Plan 2 allows each worker to invest 4 percentage points of his payroll taxes in a personal account, up to an annual

In financing terms, Plan 1 is clearly a mixed bag.

Figure 8
Monthly Benefits for a Low-Wage Retiree under Plan 2 (2052)



Source: Stephen C. Goss and Alice H. Wade, "Estimates of Financial Effects for Three Models Developed by the President's Commission to Strengthen Social Security," Memorandum dated January 31, 2002, p. 75.

Plan 1 reduces the size of general revenue infusions needed to pay full benefits by 8 percent, while paying higher benefits to all retirees, and by 2042 its costs are permanently lower than those of the current system.

maximum of $1,000. Plan 2 therefore creates a progressive personal account, with relatively larger contributions for lower income workers.

In exchange, the worker would forgo traditional benefits at an offset interest rate of 2 percent. Because the offset rate is below the government bond rate of 3 percent, workers can increase their total retirement benefits merely by investing in risk-free government bonds, which are fully backed by the government and are the legal property of the holder. Since Plan 2's low offset rate means that workers can increase their benefits without risk, its progressive account structure particularly benefits low-wage workers.

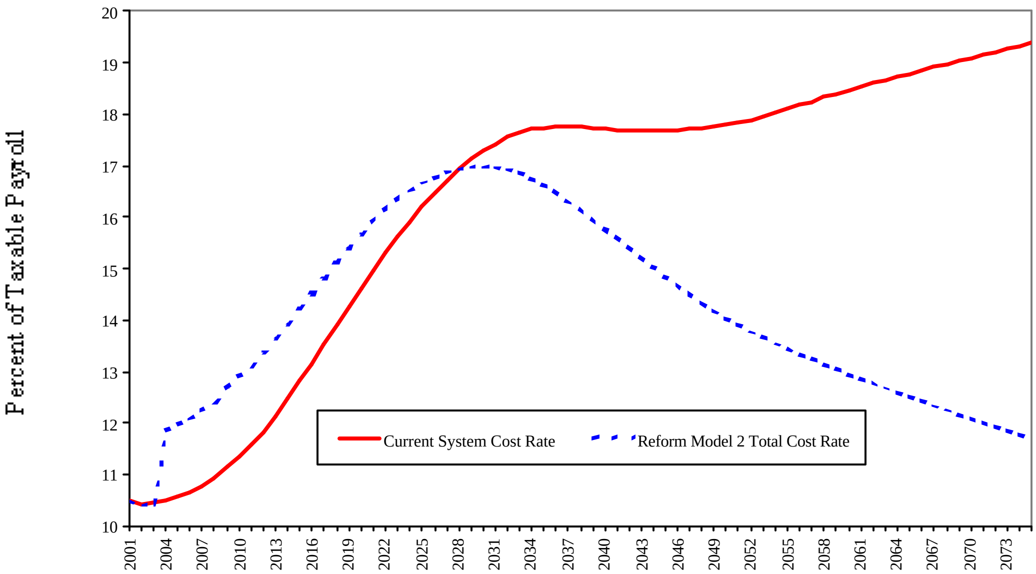
Under Plan 2, a low-wage worker retiring in 2052 and holding the standard investment portfolio would receive $1,050 per month versus the $986 per month promised by the current system and the $713 that could actually be paid (see Figure 8). Even if that worker held only government bonds in his account, he would receive a total monthly benefit of $867 (in 2001 dollars), 22 percent higher than would be paid under current law.[64]

This point is relevant to the charge that the commission reform plans would "cut guaranteed benefits." What critics reference as Social Security's "guaranteed benefit" is not guaranteed in law, as the Supreme Court has ruled.[65] Nor is it guaranteed in an economic or financial sense because the resources will not be available to provide promised benefits. Quite the contrary: We can be reasonably sure legislated resources—current payroll tax rates—won't provide nearly what has been promised. Hence, the proper baseline for "guarantees" is what the law provides and what payroll taxes can afford to pay: that is, the so-called "payable benefit." On this basis, there is simply no truth to claims that Plan 2 would "cut guaranteed benefits."

Moreover, a worker who opted for a personal account would have a stronger "guarantee" to his benefits in that, unlike the current program's benefits, the account assets are his legal property and, in the case of government bonds, are backed by the full faith and credit of the government.

Plan 2's benefit increase for low-wage work-

Figure 9
Cost of Commission Plan 2 Compared to Current System



Source: President's Commission to Strengthen Social Security, final report, p. 126.

ers is not simply a function of throwing money at the problem. Although Plan 2 pays low-wage workers higher retirement benefits than those promised by the current program, it does so at a cost 68 percent lower than that needed to maintain the current system.

One reason for this is that under Plan 2, higher wage earners do not do quite as well as low-wage earners. A high-wage worker with the default portfolio, for instance, would receive just 88 percent of his full promised benefit, and an average-wage worker 94 percent. Nevertheless, even high-wage earners receive 25 percent more than the current system can afford to pay while avoiding the massive income-tax increases many account opponents favor to keep the current program solvent.[66]

Some may charge that the general revenue infusions required to finance the transition to personal accounts are unaffordable. However, concern over fiscal pressures should be a reason to favor the commission's plans, not reject them. Account opponents who decry the revenue transfers under the commission's plans should detail how they would afford the much larger general revenue transfers necessary to maintain the current program. It is only if account opponents choose the true "do nothing" option, in which Social Security becomes insolvent and large benefit cuts are enacted, that pressures on general revenue will be less than under the commission's proposals.

To balance the current program, beginning in 2009 Plan 2 indexes the initial wages each cohort receives to the growth of prices, instead of the generally higher rate of wages indexed under current law (see Figure 9). Price indexing brings Social Security back to solvency and makes it sustainable over the long term.

This shift from wage to price indexing of initial benefits has generated controversy and merits a close look.

Social Security's current benefit formula replaces a higher percentage of low-wage workers' pre-retirement earnings than that of higher earners. For workers retiring in 2002, Social Security replaces 90 percent of the first $592 in average monthly pre-retirement earnings, 32 percent of monthly earnings between $592 and $3,567, and 15 percent of any amount between $3,567 and the taxable maximum. The benefit formula's pairings of monthly income levels and income replacement rates are known as "bend points" (see Figure 10).

For instance, a new retiree with $20,000 average indexed earnings would receive $877

Plan 2 reflects the outlook that Social Security should maintain a real inflation-adjusted foundation on which other retirement savings could build, but that this foundation should not grow at a rate unsustainable under current payroll tax rates.

Figure 10
Social Security's "Bend Point" Formula Provides Higher Monthly Benefits to Those with Lower Average Wages

Source: Social Security Administration.

There is simply no truth to claims that Plan 2 would "cut guaranteed benefits."

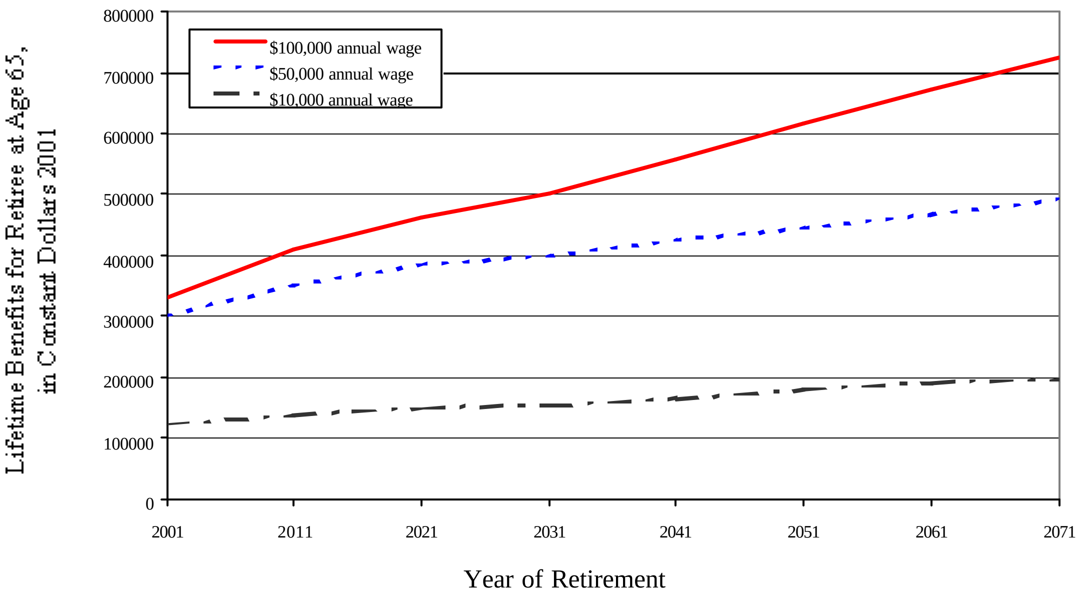
per month, or 53 percent of his pre-retirement monthly earnings. A $50,000 worker, by contrast, would receive $1,567 per month. Although this is almost twice what the $20,000 worker receives, it is only 38 percent of the $50,000 worker's pre-retirement earnings. This progressivity is intentional: higher wage workers can save more outside of Social Security, and those outside assets can provide income during retirement.

To maintain progressivity, Social Security's "bend points" are increased annually according to the growth of wages. In 2001, for instance, Social Security's 90 percent bend point was placed at the first $561 of a new retiree's average indexed monthly pre-retirement earnings, while in 2002 the 90 percent bend point rose to $592. By 2015 the 90 percent replacement level will rise to the first $661 in earnings (in today's dollars), and so forth ($767 by 2030 and $991 by 2050). The upper bend points, marking replacement rates of 32 and 15 percent, are similarly indexed to wage growth and increase each year.

Put another way, a $20,000 worker would retire today with monthly benefits of about $877, equal to 53 percent of his pre-retirement earnings. By 2050, the same worker earning the same $20,000 (in today's dollars) would receive $1,091 monthly, or 64 percent of his pre-retirement earnings. In other words, the 2050 retiree would receive 25 percent higher benefits simply due to the passage of time, even if he paid precisely the same taxes.

Moreover, under the current benefit formula, future increases in benefits will be greatest for the highest earners (see Figure 11). For instance, a worker earning $10,000 today already receives the maximum 90 percent replacement rate on much of his wages. A similar worker making $10,000 (in 2002 dollars) in 2031 will receive a 25 percent real benefit increase, and in 2071 a 58 percent increase. By contrast, higher income workers today have much of their wages covered under the upper bend points offering lower replacement rates. Over time, wage indexing pushes more of those wages into the bend points

Figure 11
Wage Indexing Gives High-Wage Workers Largest Increase



Source: Author's calculations.

offering higher replacement rates. For instance, a $100,000 worker retiring at 65 in 2001 can expect to receive about $330,000 in lifetime retirement benefits. By 2031, lifetime benefits increase by 51 percent to $499,000, and by 2071 by 120 percent to $725,000, under today's (unsustainable) benefit formula.[67]

It should be stressed that these are workers earning the same annual wages in real, inflation-adjusted dollars. Clearly, the current wage-indexed benefit formula provides vastly unequal benefits to otherwise identical workers retiring at different points in time. Wage indexing increases benefits over time, and the largest increases go to the highest earners. In fact, these figures underestimate differences in lifetime benefits, as they assume identical life expectancies for upper and lower wage workers. Because life expectancies are correlated to income, the true results are likely to be even more extreme.[68]

Moreover, as the commission noted in its interim report, wage indexing of initial benefits prevents the system from gaining much from increases in long-term economic growth.

Initial Social Security benefit levels are currently indexed to the growth in national wage levels. Consequently, even if there were no demographic problem, Social Security costs would grow almost as fast as the economy as a whole. Faster economic growth means more tax contributions in the short term, and higher benefit obligations in the long term. Though this faster growth helps, it does far less than many people believe. Mostly it creates the illusion of improvement because short-term revenue gains postpone the projected date of Trust Fund depletion, whereas increased costs would occur mostly after the projected depletion date.[69]

Even if the economy grew twice as fast as the trustees project, Social Security would still become insolvent within the 75-year scoring period.[70] Social Security's wage indexing formula is in large part responsible for that.

A solution to the problems of financing and equity is to switch from wage to price indexing of Social Security's benefit bend points. In doing so, the bend points would increase annually along with increases in the Consumer Price Index.[71] Under Plan 2, price indexing is instituted beginning in 2009, so current retirees and those over age 55 are entirely unaffected, and those under age 55 are affected only to the degree that their

Account opponents who decry the revenue transfers under the commission's plans should detail how they would afford the much larger general revenue transfers necessary to maintain the current program.

Table 3
Monthly Benefit Payable to Low-Wage Disabled Worker Scheduled to Retire in 2055 (in 2001 dollars)

Promised	$986
Plan 1	$986
Plan 2	$807
Plan 3	$857
Payable	$713
Benefit payable to low-wage worker in 2001	$637

Source: Derived from data presented in Stephen C. Gossand and Alice H. Wade, "Estimates of Financial Effects for Three Models Developed by President's Commission to Strengthen Social Security," Memorandum dated January 31, 2002.

Price indexing brings Social Security back to solvency and makes it sustainable over the long term.

working careers extend past 2009.[72] In addition, Plan 2 is not a "pure" price indexing approach, as it contains special provisions targeted toward the most vulnerable Americans—low-wage workers and widows—so that they receive higher benefits than the current benefit formula promises, much less can actually afford to pay. Whatever the large-scale financing impact of the switch to price indexing, it is difficult to portray this principle as unfair; it simply treats relevantly similar individuals in a similar way.

These facts blunt criticisms, such as those made by Kilolo Kijakazi and Robert Greenstein of the CBPP, that "replacing 'wage indexing' with 'price indexing' would result in deep reductions over time in Social Security benefits."[73] As we have seen, under a pure price indexing approach, workers with similar wages would receive similar benefits, at whatever point in time they retired.

Greenstein and Kijakazi are correct that price indexing reduces the replacement rate for an average-wage worker in any given year,[74] which they illustrate with an average-wage worker retiring in 2040: Under the current wage indexing approach, that worker would be promised a benefit equal to 37 percent of his pre-retirement earnings. Under pure price indexing, they say, his benefit would equal only 28 percent of his pre-retirement earnings. Greenstein and Kijakazi extend their example to a worker retiring in 2070, making the notional "cuts" even larger.

Several points are worth making. First, under current law, after trust fund depletion in 2038 benefits would equal whatever level payroll tax receipts are capable of paying, regardless of the wage-indexed benefit formula. Thus, under current law that 2040 retiree will actually receive a 27.4 percent replacement rate even if price indexing weren't introduced. Moreover, under Plan 2 the personal account provides retirees with benefits higher than those that a pure price indexing approach implies. The 2040 retiree could expect total retirement benefits equal to about 34.8 percent of pre-retirement earnings, assuming investment in the default 50 percent stock, 50 percent bond portfolio.[75]

Beyond this point, there is a more important difference between average-wage workers in the future and average-wage workers today: average workers in the future will earn substantially more money. The average-wage worker in 2040 will earn some 48 percent more than that of today; in 2070, almost double today's average (and more than 20 percent greater than the SSA's hypothetical "high earner" in 2001). Compared with today's workers, these future Americans will have substantially higher standards of living while working and several years greater life expectancy in retirement.

Now, workers retiring today with earnings 50 to 100 percent higher than the average would of course receive a lower income replacement rate than would an average-wage worker, and Greenstein and Kijakazi would surely be the first to defend that practice. Yet they argue that treating a similar worker in the future in a similar way is a "deep reduction."

To be fair, Greenstein and Kijakazi acknowledge that the "benefit cuts" inherent in price indexing would not, in fact, actually cut benefits: "To be sure," they say, "benefit levels would keep pace with changes in prices."[76] In other words, benefits would not be cut. But, they say, "beneficiaries would be precluded from partaking in the general increase in the standard of living from one generation to the next. Upon retiring, workers would essentially drop back to a standard of living prevalent in an earlier generation."[77]

Of course, price indexing also precludes workers from "partaking" in the 50 percent increase in payroll tax rates necessary to maintain the current wage-indexed benefit formula. The question, which Greenstein and Kijakazi don't address, is whether workers should be forced to pay those extra taxes to achieve promised replacement rates, particularly when individuals desiring a higher retirement income could invest their tax savings privately at rates of return two to three times higher than under Social Security. Why must the government force people to do something they could easily do voluntarily if they so wished?

In effect, Greenstein and Kijakazi argue that a $100,000 annual wage worker retiring in 2070 should receive some $725,000 in lifetime retirement benefits, even if payroll taxes must top 19 percent, despite the fact that a similar worker retiring today can expect just $330,000 in lifetime benefits. But why? If it is so important to give a $100,000 worker $725,000 in lifetime retirement benefits, why not raise taxes today? Greenstein and Kijakazi argue that tomorrow's taxpayers should shoulder a tax burden that they are unwilling to ask today's taxpayers to bear, but provide neither the economic nor philosophical rationale for doing so.[78]

The question remains: if higher earners today receive lower replacement rates because they are able to save more outside of Social Security, shouldn't the same reasoning apply to identical earners in the future? Isn't this particularly true given the financing burden the wage-indexed benefit formula places on the system and on the taxpayer?

In testimony before the president's commission, Hans Riemer of the Campaign for America's Future and the 2030 Center declared that "the level of guaranteed protection that Social Security provides today is about right."[79] Plan 2, and all of the other plans put forward by the commission, would maintain the level of benefits provided today and enhance benefits substantially for those in greatest need.

Despite charges made by reform opponents against price indexing today, in the past it has received support even among those who oppose personal accounts. Peter Diamond of MIT, one of the most prominent academic critics of personal accounts, was a member of a government panel in the 1970s that recommended price indexing, calling it "fair and necessary."[80] As the panel's report pointed out:

> The wage-indexing method provides a sharp tilt in favor of workers retiring in the future. The increases in benefits for workers already retired are limited to increases in the rise in the Consumer Price Index. Yet workers who retire five years later will receive increments due to both price changes and increases in real wages. This difference in retirement benefits can be substantial.[81]

When President Carter appeared to be favoring wage indexing over a price-indexed approach, Diamond and the other panel members chided him for fiscal and generational irresponsibility:

> President Carter would be displeased with his predecessors if he were currently faced with the choice of cutting Social Security benefits for present recipients or raising the same amount of revenue as would be raised by an increase in the payroll tax rate of five percentage points. Yet that is precisely what the best current estimates say he is proposing to do to some future President. . . . It appears to us that correction of overindexing by choice of a price indexing method would be greatly superior [to wage indexing]. . . . Use of the price indexing method would eliminate the need for a tax rise when the percentage of retirees increases sharply early next century. . . . While the price indexing method implies protection from inflation and a growth in benefits with the real growth of the economy, the wage indexing method calls for a much larger growth in benefits for future retirees at a time when the country may not be able to afford it. Use of the price indexing method would permit moderate tax and benefit increases to aid those recipients with greatest need as perceptions of those needs arise.[82]

The current wage-indexed benefit formula provides vastly unequal benefits to otherwise identical workers retiring at different points in time.

Price indexing also precludes workers from "partaking" in the 50 percent increase in payroll tax rates necessary to maintain the current wage-indexed benefit formula.

The same charges could be made today against those who wish to saddle future taxpayers with economic burdens they themselves are unwilling to bear today.

Henry Aaron of the Brookings Institution concurred with Diamond, arguing that price indexing "would leave more options open for spending the productivity dividend of economic growth. Congress could still raise pensions in the future, but it could also decide that other programs such as housing, health insurance, or defense have greater claims on available funds."[83] As chairman of the 1978–79 Advisory Council on Social Security, Aaron again argued for price indexing, but the change was not adopted.

> As per capita income rises, the case for increasing the amount of mandatory "saving" for retirement and disability through Social Security is far weaker than was the rationale for establishing a basic floor of retirement and disability protection at about the levels that exist today.
>
> At the levels of real income prevailing in the 1930s (or perhaps even in the 1950s), it can well be argued that it was appropriate, indeed, highly desirable—perhaps even necessary for the preservation of our society—that government should, by law, have guaranteed to the aged and disabled and their dependents replacement incomes sufficient to avoid severe hardship, and to have required workers (and their employers) to finance this system with a kind of "forced saving" through payroll tax contributions. But as real incomes continue to rise, it is not easy to justify the requirement that workers and their employers "save" through payroll tax contributions to finance ever higher replacement incomes, far above those needed to avoid hardship. Perhaps not all workers will want to save that much, or to save in the particular time pattern and form detailed by present law.

Aaron and his coauthors go on to say:

> Future Congresses will be better equipped than today's Congress to determine the appropriate level of and composition of benefits for future generations. . . . Congress might elect to give more to certain groups of beneficiaries than to others, or to provide protection against new risks that now are uncovered. But precisely because we cannot now forecast what form those desirable adjustments might take, we feel the commitment to large increase in benefits and taxes implied under current law will deprive subsequent Congresses, who will be better informed about future needs and preferences, of needed flexibility to tailor Social Security to the needs and tastes of the generations to come.[84]

The primary difference between the price indexing advocated by Diamond and Aaron and that applied in Plan 2, besides certain technical factors of implementation, is that Plan 2 provides a personal account to make up for the reduction in the growth of traditional benefits.

Subsequent to the release of the commission's recommendations, Diamond disowned his prior support for price indexing and strongly criticized the commission for having advocated it.[85] Diamond argued that he had favored price indexing in the 1970s because the financing problems facing Social Security at the time were much greater than those at present. It is true that Social Security faced a short-term financing crisis in the late 1970s due to an error in the benefit formula introduced in the 1972 amendments that implied a quantum leap in future benefit levels. But price indexing, which is extremely slow to take effect, would have done nothing to avert insolvency in the short term. Moreover, the wage-indexing alternative that Diamond and the rest of the panel argued so strongly against entailed long-term system costs barely higher than those projected by Social Security's actuaries today.[86] In addition, the Hsiao panel rejected the view that income replacement rates should be the basis of Social Security's benefit formula, as is the case under wage indexing.

To summarize Plan 2:

- Workers can voluntarily redirect 4 percent of their payroll taxes up to $1,000 annually to a personal account (the maximum contribution is indexed annually to wage growth). Traditional Social Security benefits are offset by the worker's personal account contributions compounded at an interest rate of 2 percent above inflation.

- Workers opting for personal accounts can reasonably expect total benefits greater than those paid to current retirees, to workers without accounts, and to future benefits payable under current law.
- Plan 2 establishes a minimum benefit payable to 30-year minimum-wage workers of 120 percent of the poverty line. Survivors' benefits for below-average-wage workers would be increased by 33 to 50 percent.
- Beginning in 2009, calculation of traditional benefits would switch from wage indexing to price indexing. Current retirees and workers aged 55 and over would be entirely unaffected.

Commission Plan 3

Plan 3 aimed to match or exceed benefits currently promised by Social Security for all workers, but to do so at lower cost than the current program. In this, it succeeds.

Plan 3's accounts are designed as a combination add-on and carve-out. That is to say, if a worker agrees to contribute an additional 1 percent of his earnings to the account, he may "carve out" 2.5 percentage points of his payroll taxes up to an annual maximum of $1,000.

Workers opting for personal accounts would accept an offset at a 2.5 percent interest rate. Again, for a low-wage worker investing in government bonds, the guaranteed benefit is both higher and more "guaranteed" than under the current system.

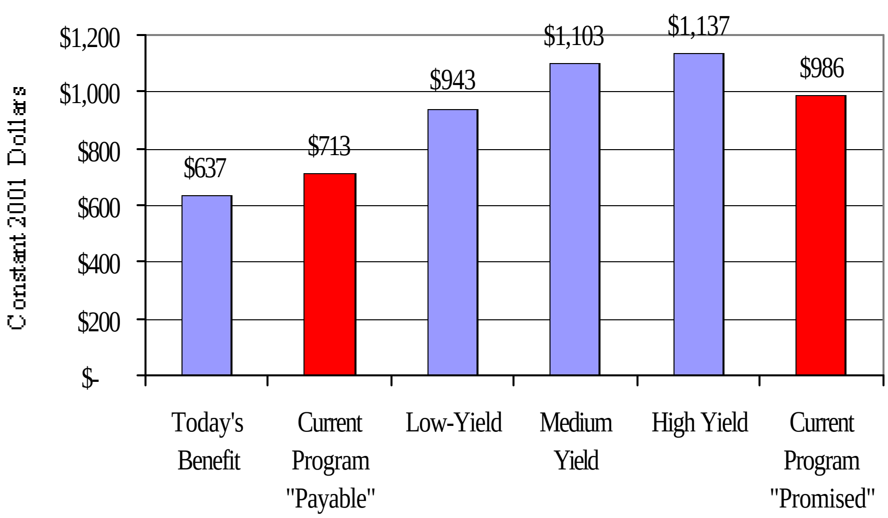
Under Plan 3, a low-wage worker with the default investment portfolio would receive $1,103 per month in total expected retirement benefits, as opposed to the $986 promised by the current program and the $713 actually payable (see Figure 12). All other workers, at all other times, could expect benefits at least as high as those promised by the current program.

To bring the traditional program back to balance, Plan 3 requires new ongoing sources of general revenue, equivalent in size to increasing the payroll tax cap to 90 percent of taxable payroll and redirecting to Social Security the portion of benefits taxation that currently flows to Medicare.

Two points are worth making in this regard. First, it should be emphasized that Plan 3 describes only the size of the general revenue transfers and not the means. The commission worked under the president's principle that payroll taxes would not be raised, and this was taken to encompass increases in the taxable wage base as well as the payroll tax rate. Second, increased revenue commitments were

"As real incomes continue to rise, it is not easy to justify the requirement that workers and their employers 'save' through payroll tax contributions to finance ever higher replacement incomes, far above those needed to avoid hardship."

Figure 12
Monthly Benefits for Low-Wage Retirees under Plan 3 (2052)



Source: Stephen C. Goss and Alice H. Wade, "Estimates of Financial Effects for Three Models Developed by the President's Commission to Strengthen Social Security," Memorandum dated January 31, 2002, p. 76.

For a low-wage worker investing in government bonds, the guaranteed benefit is both higher and more "guaranteed" than under the current system.

included for ensuring that benefits for all retirees exceeded the replacements rates promised in the current benefit schedule. However, it is not clear why current replacement rates should be the standard many decades in the future, as the prior section on price indexing points out. Third, even if meeting promised replacement rates were the goal, given the relative efficiencies of pay-as-you-go and funded systems it would make sense to meet this goal with a larger personal account rather than increased taxation. Doing so would entail greater prefunding, but on the whole that is a desirable thing.

One problem with Plan 3 is that mandating additional worker contributions to take advantage of the personal account might discourage lower wage workers from taking part, even if the additional contributions are partially subsidized by the government. Indeed, experimental individual development account trials aimed at lower-income workers often have far from universal participation, even with substantially more generous matches than included in Plan 3.[87] And according to the 1998 Retirement Confidence Survey conducted by the Employee Benefit Research, some 40 percent of workers said they could not save even an extra $20 per week for retirement.[88] Among low-wage workers, this percentage would likely be even higher.

Adverse selection in terms of account participation could complicate overall system financing, and would also prevent lower wage workers from reaping the benefits of asset ownership under Plan 3. In terms both of participation rates and administrative simplicity, the poor might do better if the progressive carve-out approach used in both Plans 2 and 3 were simply expanded. This would make achieving actuarial balance within the 75-year window more challenging, but from a public policy perspective it would do more to enhance retirement income and asset accumulation among the poor.

To balance system finances, Plan 3 makes several changes to Social Security's benefit structure. First, it would adjust benefits for future retirees to account for increases in longevity. In addition, the benefit penalties for retiring early—and the rewards for working later—are increased to encourage people to stay in the workforce longer. Some would argue that these changes constitute an increase in the retirement age.[89] This is incorrect: under Plan 3, the normal retirement age would remain the same as under current law. Thus, workers could still retire at any age past 62 and still receive more than current law would pay them. It is ironic that the Campaign for America's Future has issued press releases attacking Plan 3's purported increase in the retirement age, while in testimony before the commission Roger Hickey of the CAF praised a reform proposal by Henry Aaron and Robert Reischauer that explicitly raises both the normal and the early retirement ages.[90]

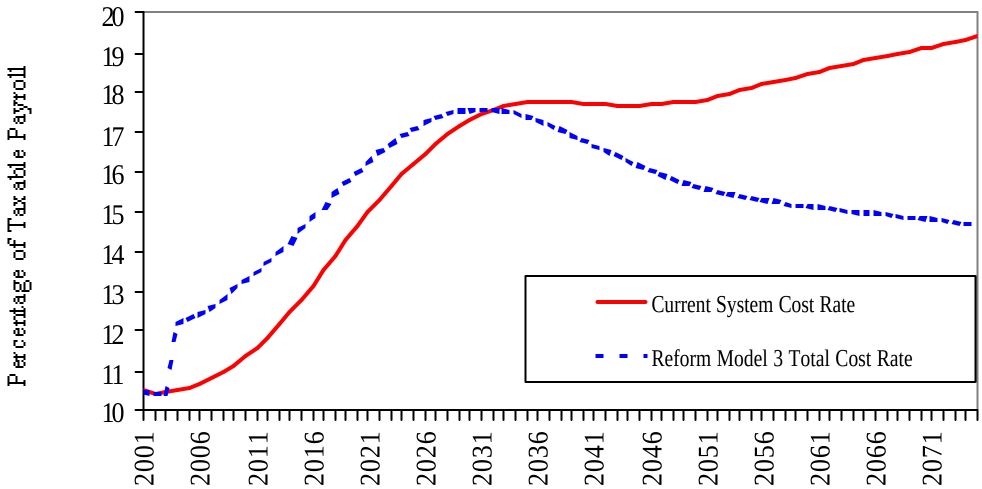
Moreover, Plan 3's changes to benefits would not even begin until 2009, so current retirees and those over age 55 are not subject to any changes. For individuals retiring soon after 2009, the changes would be tiny—just a penny on the dollar—and that offset would be more than made up by gains from the personal account.

Over the long term, Plan 3's changes would pay higher benefits for a lower cost than under the current program (see Figure 13). If the new general revenue transfers were included, it would bring Social Security back to cash surpluses and long-term sustainability for half the cost of maintaining the current program.

The commission's treatment of disability benefits has been received with some level of confusion. For instance, a memo prepared by the staff of Rep. Robert Matsui (D-Calif.) alleged, "The President's Social Security commission recommended cutting disability benefits to help pay for the cost of private accounts."[91] In fact, the commission made no specific recommendations regarding the long-term financing of Social Security's Disability Insurance program, which provides benefits to workers who through illness or injury are unable to continue to work.

Under the commission's proposals, a worker with a personal account who becomes disabled would receive the traditional Social Security benefit without any offset for holding the account. Only at retirement would he access his account balance, and only at retirement would his traditional benefit be offset on the basis of his account contributions. A worker who became disabled early in life would have made few contributions, and thus would have a very small offset to his traditional benefits. But as long as his account earned more than the offset interest rate, he could still anticipate higher total benefits than if he had remained in the current program.

Figure 13
Cost of Plan 3 Compared with Cost of the Current System



Source: President's Commission to Strengthen Social Security, final report, p. 13.

For instance, a low-wage disabled worker scheduled to retire in 2055 would receive under Plan 1 disability benefits before retirement equal to those promised by the current system and 30 percent higher than current law; Plan 2 would pay benefits 13 percent higher than current law; and Plan 3, 20 percent higher than current law. As these disabled workers would receive more than current law could pay them, it is clear that disability benefits have not been cut to fund personal accounts.

Charges of "cuts" come about because disabled workers under the three commission proposals would receive the benefits dictated under those proposals, which under Plans 2 and 3 are somewhere between those promised and those actually payable under current law (see Table 3). But, as noted, the "promised" benefit is not a valid benchmark of comparison because no means of funding that promise is available at present. The current program cannot keep its promises past the year 2041 without increasing the payroll tax by 50 percent. Moreover, any reductions in promised benefits are due to the system's insolvency, not to the introduction of personal accounts. Accounts are designed to make up for Social Security's inability to pay promised benefits.

It is worth noting the complications facing any reform's treatment of disability insurance. On one hand, the Disability Insurance program is distinct from the Old Age and Survivors Disability Insurance program, having its own dedicated tax and its own trust fund. At the same time, the two sides of Social Security share a common formula for calculating benefits, and changes to the calculation of retirement benefits can also affect the DI program. Moreover, the DI program faces financing challenges even steeper than those of OASDI—without change, the DI program will run payroll tax deficits by 2009 and its trust fund will be exhausted by 2028.

Lacking comprehensive disability reform, several options are open to reformers of the retirement program, none of them ideal:

- Separate the OASI and DI programs so they run independently. At present, although the programs have separate taxes and trust funds, they share a common benefit formula. Although this would isolate DI from any changes to OASI, DI is even more severely underfunded and would therefore become insolvent sooner.
- Retain the integration of OASI and DI but allow DI to continue under pre-reform criteria. While this would protect DI recipients from any changes, it would also create an incentive for workers nearing retirement

Mandating additional worker contributions to take advantage of the personal account might discourage lower wage workers from taking part, even if the additional contributions are partially subsidized.

Table 3
Monthly Benefit Payable to Low-Wage Disabled Worker Scheduled to Retire in 2055 (in 2001 dollars)

Promised	$986
Plan 1	$986
Plan 2	$807
Plan 3	$857
Payable	$713
Benefit payable to low-wage worker in 2001	$637

Source: Derived from data presented in Stephen C. Goss, Chief Actuary and Alice H. Wade, Deputy Chief Actuary, "Estimates of Financial Effects for Three Models Developed by President's Commission to Strengthen Social Security," Memorandum presented on January 31, 2002.

Plan 3's changes to benefits would not even begin until 2009, so current retirees and those over age 55 are not subject to any changes.

to seek to qualify for disability benefits. An increase in DI applications could speed the program's insolvency.

- Apply changes to OASI and DI universally, acknowledging that further steps must be taken to protect disabled workers as well as to reform the DI program in general.

It was the third option that the commissioners took.

In doing so, the commission emphasized that "in the absence of fully developed proposals, the calculations carried out for the commission and included in this report assume that defined benefits will be changed in similar ways for the two programs." However, *"this should not be taken as a commission recommendation for policy implementation.* . . . The commission recognizes that changes in Social Security's defined benefit structure and the role of personal accounts may have different implications for DI and OASI beneficiaries. The commission urges the Congress to consider the full range of options available for addressing these implications."[92] In other words, the commissioners anticipated that additional steps would be taken to address the DI program, and that these steps could require additional funding as well as broader structural reform.

The commissioners agreed with the Social Security Advisory Board, which declared, "After two additional years of study of the disability programs. . . . we are convinced that the issues facing the disability programs cannot be resolved without making fundamental changes."[93] Unfortunately, the deliberate focus of the president's commission on the financing problems of the retirement portion of Social Security and the short period available for the commissions' work made the development of comprehensive disability reform proposals impossible. The commission did recommend, however, "that the President address the DI program through a separate policy development process."

As the independent Social Security Advisory Board has argued, the disability program requires reforms extending beyond mere financing changes.[94] Decisions on disability eligibility vary greatly between states, with some states approving DI claims at over twice the rate of others, and are many times resolved only through adjudication. Moreover, awards based on mental conditions have more than doubled as a percentage of total DI claims between 1980 and 1990, and now make up the largest single reason for DI claims. State agency administrators and examiners report that at least half of the claims processed now involve issues relating to mental impairment.[95] Clearly, the nature of disability claims is changing quickly and radically, and the program requires a comprehensive assessment of how it is to function and what clams should be met. The complexity of DI's structure and function causes its administrative costs to be five times higher than those of OASDI relative to its income.[96] Without a doubt, more changes will be needed to bring DI back to long-term health

To summarize Plan 3:

- Workers who invest an additional 1 percent of wages in a personal account may also invest 2.5 percentage points of payroll taxes, up to $1,000 annually. The add-on contribution is progressively subsidized by a refundable tax credit, enhancing the progressivity of the account.

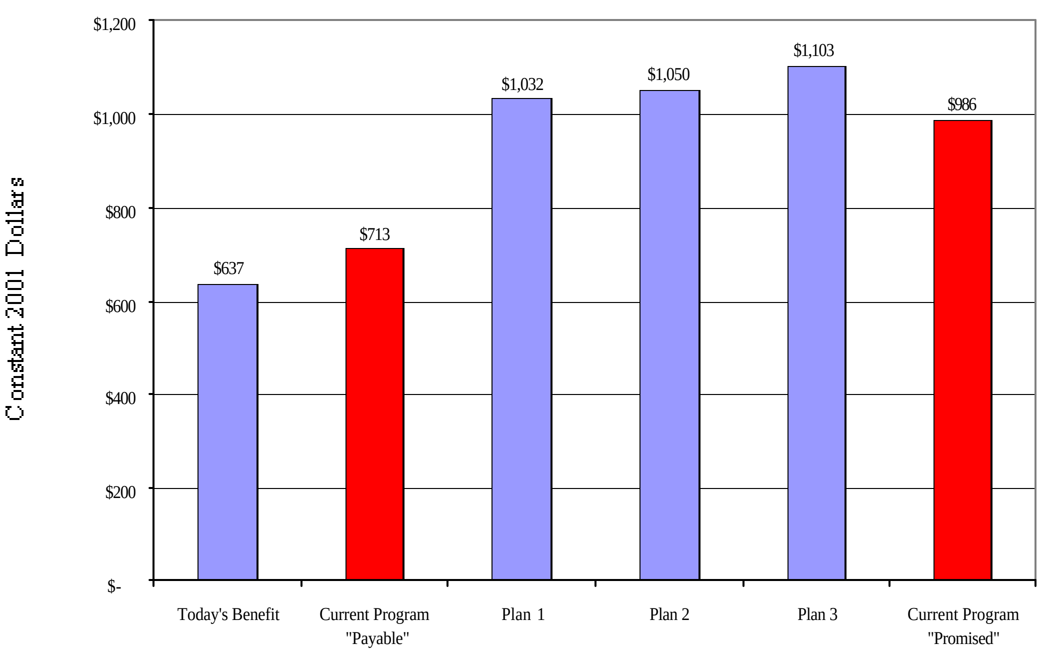
- Account-holders accept an offset to their traditional Social Security benefits at a real annual interest rate of 2.5 percent. Hence, under Plans 2 and 3, workers could increase their total retirement benefits by simply investing in government bonds.
- Plan 3 increases system progressivity by establishing a minimum benefit payable to 30-year minimum-wage workers of 100 percent of the poverty line (111 percent for a 40-year worker). This minimum benefit would be indexed to wage growth. Benefits for below-average-wage earners would be increased as well.
- The growth rate of traditional benefits would be adjusted to reflect increases in life expectancy; the offset for early retirement and bonus for later retirement would be increased; and the third bend point factor affecting higher-wage retirees would be reduced from 15 to 10 percent.
- Benefits payable to workers who do not opt for personal accounts would be more than 50 percent higher than those paid to today's retirees.
- New sources of dedicated revenue would be added in the equivalent amount of 0.6 percent of payroll over the 75-year period, and continuing thereafter.
- Additional temporary transfers from general revenues would be needed to keep the Trust Fund solvent between 2034 and 2063. Total cash requirements would be 52 percent of those needed to maintain the current program.

Summary of the Three Plans

Taken together, the commission's three reform plans show the power of personal accounts to address the problems associated with Social Security.

The deliberate focus of the president's commission on the financing problems of the retirement portion of Social Security and the short period available for the commissions' work made the development of comprehensive disability reform proposals impossible.

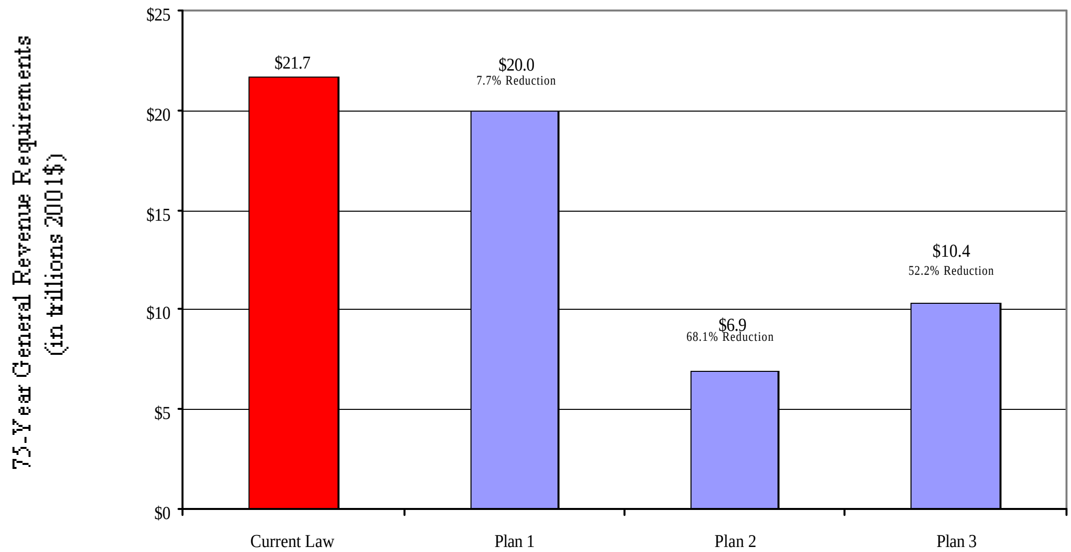
Figure 14
All Three Plans Would Pay Higher Benefits Than under Current Law



Source: President's Commission to Strengthen Social Security, final report. Low-wage worker retiring in 2052; assumes investment in 50–50 stock–bond portfolio.

Under Plans 2 and 3, workers could increase their total retirement benefits by simply investing in government bonds.

Figure 15
All Three Plans Would Require Less General Revenue Than the Current Program



Source: President's Commission to Strengthen Social Security, final report, p. 22. Based on current program finances as projected in 2001 Social Security Trustees Report.

- Each of the three commission proposals would pay future beneficiaries higher expected benefits than those received by today's retirees.
- Each of the three proposals would increase expected benefits relative to what the current system can pay.
- Each of the three proposals would increase expected benefits for those who opt for personal accounts relative to those who stay in the traditional system.
- Each of the comprehensive reform proposals (Plans 2 and 3) would increase expected benefits for those who opt for personal accounts, even if participants invested in the most conservative portfolio available (government bonds).
- Each of the three proposals would increase expected benefits for low-income participants even relative to currently promised benefits (which cannot be paid without significant tax increases). These low-wage participants would receive higher benefits than if Social Security were fully funded and faced no financial crisis whatsoever. Two of the proposals institute, for the first time, a guarantee that minimum-wage workers not retire in poverty.
- Two of the three proposals would institute special benefit increases for widows of low-income participants, raising incomes for millions of Americans most vulnerable to poverty in retirement.
- Two of the three proposals would increase expected benefits for all of the participants in personal accounts even relative to the benefits the current system promises, much less can afford to pay.
- One proposal makes no changes whatsoever to Social Security's benefit structure other than to offer workers the opportunity to increase their total benefits by owning a personal retirement account.
- Under all of the proposals, participants receive more benefits for less money relative to the current system.

All three plans would pay higher benefits than are paid under the current system (see Figure 14), and lower-income workers—those who account opponents claim to be most concerned about—receive benefits higher than those the current program even promises.

Moreover, all three plans would produce those benefits at lower general revenue costs than the current program (see Figure 15).

Table 4
Total System Assets as of 2076 under Current Law and Commission Reform Models (Present Value in Billions of Dollars, Discounted to January 1, 2001)

Likely Participation Rate		OASDI Trust fund Assets[a]	Current Personal Account and Annuity Assets	Total
	Present law	-3,230	NA	-3,230
Model 1	67% account participation	-3,826	1,080	-2,746
	100% account participation[b]	-4,124	1,619	-2,505
Model 2	67% account participation	380	1,290	1,670
	100% account participation	423	1,935	2,358
Model 3	67% account participation	185	1,602	1,620
	100% account participation	270	2,401	2,671

Source: Based on table from Stephen C. Goss and Alice H. Wade, "Estimates of Financial Effects for Three Models Developed by the President's Commission to Strengthen Social Security," Memorandum dated January 31, 2002, p. 24. The net current accrual for future benefit offset equals the net future savings to the traditional system as the result of benefits offset before the end of the scoring period.

a. Negative values are the OASDI unfunded obligation for the period 2001 through 2075.
b. For Model 2, 67 percent participation is considered more likely if the benefit offset yield rate is computed as 2 percent above the realized or expected inflation rate, but 100 percent participation is considered more likely if computed as 1 percent below the market yield on Treasury bonds. Based on the intermediate assumptions of the 2001 Trustees Report and other assumptions described in the text.

Assuming future payroll tax surpluses are unavailable for transition financing, the transition cost of Plan 1 is $1.1 trillion; Plan 2, $0.9 trillion; and Plan 3, $0.4 trillion. If future payroll tax surpluses were made available to fund reform, as they should be, costs would decline to $0.7 trillion for Model 1, $0.4 trillion for Model 2, and $0.1 trillion for Model 3. These latter values equal 0.29 percent, 0.33 percent, and 0.10 percent of GDP during the scoring period, substantially less than the cost of maintaining the current program.

Even Plan 1, the "accounts only" approach, cuts 75-year general revenue costs by 8 percent, while Plan 2 reduces costs by 68 percent and Plan 3 by 52 percent. In other words, the government could devote twice as much extra money to the traditional system and low-wage workers would still receive lower benefits than they would under plans 2 and 3. The commission's success was that it showed how to deliver higher long-term benefits at lower long-term costs.

Finally, all three plans would leave Social Security with substantially greater assets over the long term. As noted previously, Social Security's actuaries opine that although personal accounts are the property of individuals, for accounting purposes their assets should be treated as part of total system assets. A comprehensive view of Social Security's asset position combines account balances with the balance of the traditional trust.

Table 4 details the increases in total system assets as of 2076, the end of the traditional 75-year actuarial scoring period. Clearly, any arguments that the commission's personal account plans "de-

These low-wage participants would receive higher benefits than if Social Security were fully funded and faced no financial crisis whatsoever.

All three plans would produce those benefits at lower general revenue costs than the current program.

fund" Social Security are rebutted by these figures. By 2076 the current Social Security program would be underfunded by $3.23 trillion, in present value terms. By contrast, even under Plan 1, which makes no structural changes to Social Security's revenue or benefit formulas other than to incorporate optional personal retirement accounts, Social Security's deficit is reduced to $2.75 trillion, assuming that two-thirds of eligible workers choose to participate in personal accounts. Under Plan 2, Social Security would have net assets worth $1.67 trillion, and under Plan 3, $1.79 trillion. All of these figures are present values, that is, the amount those future lump sum assets—or debts—would be worth to individuals today.

Where from Here?

With the commission's work done, where does the Social Security debate go from here? The events of September 11, 2001, clearly reshaped many of the government's priorities, pushing national security concerns to the front burner, and rightly so.

That said, baby boomers will still begin to retire in 2008, the American population will still continue to age, and low birth rates will still reduce the ratio of workers to retirees. Like it or not, Social Security's problems remain as real and as pressing since September 11 as they were before that date. In fact, the latest report from Social Security's trustees, released in March 2002, shows the program's long-term cash deficits increasing, from $21.7 trillion in the 2001 report to $23.9 in the latest edition.

If anything, the war on terrorism reminds us that the federal government has other important functions to accomplish, and allowing Social Security and other entitlement programs to grow out of control clearly threatens the government's ability to conduct those duties.

Some have treated Social Security reform as a luxury to be undertaken when the government happens to be flush with cash. In fact, it is a necessity that becomes even more important when the government finds itself squeezed between its various duties. Those who introduced Social Security reform plans before the era of budget surpluses understood this, and the rest of the reform community should as well. The correct question isn't whether we can afford to reform Social Security, but whether we can afford not to.

Nevertheless, all of the commission's proposals demand an up-front investment. That's what pre-funding is: putting aside extra money now to save money later. When surpluses have disappeared and their reappearance is questionable, how can we muster the courage—not to mention the cash—to move reform forward?

The common objection to the commission's plans is that they don't say where they'll get the money to fund the transition. The quick answer to that is that reformers will get it from the same place reform opponents will get the money to keep the current system afloat, except they'll need a lot less of it—up to 68 percent less, to be precise.

The more thoughtful answer is that tough decisions indeed need to be made, but if we make them now in the context of reforms using personal accounts they'll be a lot less tough and be accomplished a lot sooner than if we don't. Yes, there will be a transition period of moving to personal accounts, but after that we're off the hook. If we don't move to personal accounts and simply let the program stagnate, we're on the hook forever. It is reform opponents who need to come up with the most cash, and most of them refuse to put forward any proposals for doing so.

At this point, the Social Security debate is like a sporting event at which only one team has shown up. The president has confronted one of the most contentious issues in politics and taken the heat for doing so. Congressional reformers such as Reps. Jim Kolbe (R-Ariz.) and Charlie Stenholm (D-Tex.), Sens. Judd Gregg (R-N.H.) and John Breaux (D-La.), and Reps. Richard Armey (R-Tex.), Jim DeMint (R-S.C.), and Clay Shaw (R-Fla.) have introduced their own reform plans and continue to fight for change. Each proposal has its pros and cons, but at least these reform plans are in the public arena where the costs and benefits can be discussed and assessed.

But where is Senator Daschle's reform plan? What does Dick Gephardt think we should do? Rep. Robert Matsui in press releases denounces the commission's proposals, "I could have done this by myself in two hours,"[97] yet he apparently hasn't found any spare time in a 24-year congressional career to actually sponsor a legislative proposal other than one that would have the trust fund invest in municipal bonds that pay a lower return than the fund's current bonds.

Account opponents sometimes refer to the reformers' "secret plan," but the biggest secret is what they would do to address the solvency and sustainability of a program that constitutes the biggest tax most workers pay as well as the biggest source of income to most retirees.

This fact was made embarrassingly clear in testimony before the commission by representatives of the Campaign for America's Future, a coalition of personal account opponents who were active in opposing the commission. While calling for "bipartisan dialogue," the CAF took every opportunity to poison the well of public debate. Before the commission even met, the CAF issued "biographies" of the commissioners that, for instance, described commission co-chairman Richard Parsons as having a "proven track record as a corporate executive willing to undermine the retirement security of his employees," Robert Johnson of Black Entertainment Television as "refusing to pay fair wages" to entertainers, and highlighted any and all links commission members may have to the investment sector. Throughout the process, the CAF issued press releases and published op-eds charging the commission with "ignoring key critics of President Bush's privatization proposal." (As it happens, key critics of personal accounts such as Rep. Robert Matsui were invited to meet with the commission, in public or private, but declined to do so.)

Given these charges, one would assume that when two leading members of the Campaign for America's Future were invited to testify before the commission, they would have come prepared with constructive alternatives to personal accounts. Indeed, at the commission's public hearing in San Diego it at first seemed that specific options would be debated, when CAF founder Roger Hickey stated:

> It is well known that there are proposals to strengthen Social Security without privatizing and without across-the-board benefit cuts or tax hikes. They have been put forward by many experts: Henry Aaron, former commissioner Robert Ball, economist Peter Diamond at MIT, Dean Baker and others. We should be debating the details of these pragmatic plans, we believe.[98]

What appeared less well known to Hickey was that the plans he cited are far from lacking "across-the-board benefit cuts or tax hikes":

- Henry Aaron's proposal with Robert Reischauer increases both the early and the normal retirement ages as well as increasing the benefit computation period, both of which constitute across-the-board cuts in promised benefits (and are termed as such by Aaron and Reischauer); the Aaron-Reischauer plan also includes increases in the maximum taxable wage, government investment in the stock market, and other changes.
- Robert Ball's proposal with the 1994–96 Advisory Council on Social Security would increase payroll tax rates in the future, reduce annual cost-of-living adjustments, and increase the benefit computation period, along with other changes such as government investment in the stock market.
- Dean Baker of the Center for Economic and Policy Research would increase payroll tax rates on all workers as well as the base wage on which taxes are levied.
- Peter Diamond of MIT would force state and local workers to enter the system; raise the maximum wage subject to payroll taxes; increase taxes on benefits and eliminate the current tax exemption for low-income retirees; index benefits for life expectancy to about half the degree done in Plan 3; and phase in payroll tax increases.[99] This proposal, however, has never been fully analyzed for solvency.

Hickey eventually acknowledged to commissioner Fidel Vargas that his preferred course of action was to repeal the recent tax cuts passed by Congress and spend the proceeds on non-Social Security programs, in hopes that this would spur economic growth and benefit Social Security. The probability that additional federal spending will spur economic growth is for individuals to judge, but it is worth pointing out that economic growth would need to double for Social Security to remain technically solvent throughout the 75-year actuarial scoring period.[100]

Hans Riemer, Roger Hickey's colleague at the Campaign for America's Future, exhibited better knowledge of existing reform proposals when he testified before the commission in Washington, D.C., but he demonstrated the same lack of seriousness when it came to discussing the alternatives to personal accounts. Riemer offered general prescriptions, such as repealing the recent tax cuts, increasing or

It is reform opponents who need to come up with the most cash, and most of them refuse to put forward any proposals for doing so.

The commissioners did not claim that their plans constitute a free lunch. Rather, they merely maintained that there proposals met the president's principles for reform and are superior to the alternatives.

removing the "cap" on income to which the payroll tax applies, and investing the trust fund in the stock market (this last option is particularly puzzling given that Riemer simultaneously endorses the view that future stock returns cannot exceed 3.5 percent annually, which would make trust fund investment practically worthless in terms of achieving solvency).[101] When pressed for a more specific, comprehensive plan that could be scored by Social Security's actuaries and compared with the plans put forward by the commission, Riemer agreed to do so, and reiterated this agreement at later dates.[102] In the end, though, Riemer never delivered the promised proposal.

The commissioners did not claim that their plans constitute a free lunch. Rather, they merely maintained that their proposals met the president's principles for reform and are superior to the alternatives. Account opponents' determination to keep those alternatives a secret implicitly acknowledges that the commissioners are right. The sad state of the political discussion over Social Security is revealed not in reformers' disagreement with their opponents' policy proposals, but in the difficulty of discerning precisely what policy proposals reform opponents actually favor. Realistically, however, an unwillingness to embrace any reform plan is an acceptance of the status quo. This is fine, as long as everyone recognizes that the status quo allows Social Security to go broke. Until both sides lay their cards on the table and declare specifically what they wish to do, there is little taking place in the way of debate.

Conclusion

The President's Commission to Strengthen Social Security took seriously its task to formulate proposals incorporating voluntary personal accounts that would not merely ensure the solvency of Social Security, but contribute to its long-term sustainability as well. Sustainability means more than making Social Security's assets equal its liabilities in a bookkeeping sense over a 75-year period. Reform must ensure that, in an overall economic and budgetary sense, Social Security truly saves for the future, preparing the program and the country to support a growing population of retirees through 2075 and beyond.

The commission's three reform proposals represent a range of ways to use private, individually controlled investment to strengthen Social Security and to build assets and wealth for Americans who need them most. None of the plans is perfect, and each constitutes a compromise between commission members. The first appendix includes the author's own criteria for reform, against which the commission proposals can be assessed.

Nevertheless, all three commission plans move Social Security toward a sustainable future and contribute to the overall reform effort. The commission's Plan 2, in particular, would allow workers to regain control over their retirement savings while giving the federal government the budgetary flexibility that comes from a pension program that can live within its means.

In his 2002 State of the Union address, President Bush said that the fight against terrorism wasn't just our responsibility, but our privilege. That sentiment applies just as well to Social Security reform. It would be very easy to sit back and do nothing—to keep spending the program's surpluses and pretending the problem will fix itself, then feigning surprise when it doesn't. But to do so would sell us all short. Addressing Social Security's problems today, making the tough choices now instead of passing them off to others, is not just this generation's obligation, it is its privilege.

Appendix: Analytical Framework

What follows is a basic analytical framework of the primary policy issues that must be addressed regarding Social Security reform. Answers to these four questions—whether to fund, where to fund from, how much to fund, and what to fund do not depend on any particular philosophical or ideological beliefs.

Whether to Fund

The first question, whether to fund, asks whether it is desirable to move away from Social Security's current pay-as-you-go financing, in which each working generation pays the benefits of the current retired generation, to a funded status, in which each working generation accumulates and holds assets to provide income in its own retirement. Note that, at this stage, no distinction need be made between funding through a central investment strategy or through personal accounts.

The advantage of pay-as-you-go funding is that it can begin paying benefits quickly: the Social Security Act was passed in 1935 and the program began paying out retirement benefits just five years later. By contrast, a funded system demands a full working lifetime before it can begin paying full retirement benefits.[103]

The advantage of a funded system is that at any given time it pays a substantially higher rate-of-return than does a pay-as-you-go program. This rate of return difference is not simply the opinion of right wing economists; liberal economists Paul Samuelson of MIT and Henry Aaron of the Brookings Institution established during the 1950s and 1960s that a pay-as-you-go system like Social Security will pay a rate of return roughly equal to the growth rate of the taxable wage base—that is, labor force growth plus wage growth.[104] From 1960 to 2000, this pay-as-you-go rate of return equaled 2.9 percent after inflation.

By contrast, the return to capital during that same period was 8.5 percent after inflation.[105] The difference was not based on risk—both "returns" fluctuated over time—but on the economic fundamentals involved.[106] Peter Diamond of MIT, a prominent opponent of personal accounts, found that under typical circumstances the return from a funded system should exceed that of a pay-as-you-go system, and historically this difference has been wide.[107]

The upshot is that a funded system, however structured, can pay the same benefits at substantially lower cost than a pay-as-you-go system. This advantage goes for a funded defined-benefit government-run system just as much as for a decentralized personal account program. Over a 45-year working lifetime, a funded system at the historical return to capital pays benefits at one-sixth the cost of a pay-as-you-go plan. Even at a more modest return of 5 percent, which is closer to what could be expected from an actual investment portfolio, the long-term cost is just half that of a pay-as-you-go system.[108]

The conclusion then, based on the work of economists opposed to personal accounts, is that over the long term a pay-as-you-go system is simply less efficient than a funded program.

Yet, while vastly inefficient over the long term, pay-as-you-go programs like Social Security are highly efficient in the short term: not in the sense that the program's administrative costs are low—though for the retirement and survivors' programs, they are—but in that under a pure pay-as-you-go system all of the money paid in today is used today to pay benefits.[109] There is no "waste, fraud, and abuse" to cut, no way to use the money actually paid to retirees more efficiently. In short, to move from an unfunded system to a funded system you have to come up with additional funds. This raises the obvious question, "From where?"

Where to Fund From

To move from an unfunded pension system to a funded system, several sources of funding are available. The first source, and the least likely on a large scale, is current retirees. If we were to reduce benefits to today's retirees, workers could simply shift their payroll taxes from supporting today's generation to saving for their own. But this would constitute a changing of the rules after the game has been played, which most people would consider unethical.[110] The fact that the current system does not and cannot guarantee benefits does not mean that policymakers should fund reforms at retirees' expense. Moreover, many retirees have few resources other than Social Security, so large-scale reductions in payments to current retirees would throw many into poverty. This is hardly the goal of reform.

Some reform plans have adopted tax increases as a funding source. In one sense, it seems like an obvious solution: why not simply obtain the money from the same place government gets all its other money? Although revenue increases are feasible on a small scale, if not desirable from a philosophical viewpoint, any tax increase is likely to fall on higher wage workers who already save large portions of their incomes. Because these workers may reduce personal saving in response to such a tax increase, this route could give the appearance of increasing saving without actually accomplishing it.

Similar objections apply to debt financing the transition to reform. It is common sense that you can't increase saving through borrowing. The economic benefits of a funded system flow from increases in saving, and increased saving

Reform must ensure that, in an overall economic and budgetary sense, Social Security truly saves for the future, preparing the program and the country to support a growing population of retirees through 2075 and beyond.

means reduced consumption, at least in the short term.[111] Under a debt-financed transition to "funding," either based on personal accounts or centralized government investment, the increased benefits from the funded system would be offset by higher debt service costs, and the higher return from the funded system would be offset by the rate of return on the outstanding debt. Debt financing, again, gives the appearance of economic pre-funding without the substance.[112]

The fourth possible source of funding is reductions in other government spending. It is said that a government program is the closest thing to immortality on this earth. Programs can continue year after year because they benefit the interests of those who sponsor them, even if their net benefit to society and the economy are small or even negative.

Recalling the real return to capital cited before—8.5 percent after inflation—it is difficult to imagine many government programs yielding this return at the margin, or even well in from the margin. There are exceptions, of course; as certain government functions such as national defense or police forces are prerequisites to most nongovernment economic activities, basic government services presumably produce average returns above those available in the market.

In general, however, existing estimates suggest below-market returns from most public investment. Paul Evans and Gregorios Karras examined state government spending on education, highways, health and hospitals, police and fire protection, and sewers and sanitation, measuring whether increased government investment in those functions raised state economic output. In general, they found the opposite: "We find fairly strong evidence that current government educational services are productive but no evidence that the other government activities considered are productive. Indeed, we typically find statistically negative productivity for government capital."[113] Because the federal government spends relatively little on education, we may infer that the losses from reductions in federal investment spending would be outweighed by gains to Social Security were those funds invested on its behalf.

From this perspective, the preferred route to a funded pension system is through reductions in existing or projected federal government spending rather than through increased taxation or public debt. That said, though, how much funding is desirable? And thus, how big should those reductions in spending be?

How Much to Fund

How much funding to seek is as much a value judgment as an economic question. From an efficiency standpoint, it stands to reason that over the long term a public pension program should be fully converted from an unfunded to a funded status. Although some argue that a mix of pay-as-you-go and funded financing diversifies risks, it is my view that—all other things being equal—the greater efficiency of funded pensions outweighs the benefits of diversification with pay-as-you-go financing.

That said, however, preferring funding over pay-as-you-go is only half the question. The other half is, even in the absence of pay-as-you-go financing, how much funding do we wish to do? Do we wish to devote the entire 12.4 percent current payroll tax rate to a future funded program, or should we settle with a smaller amount?

At the rate of return to capital, a funded program can produce the same benefits as the current system at a payroll tax rate of less than 3 percent. Assuming a 5 percent return, the required payroll tax rate would be approximately 6 percent, though a cushion would obviously be necessary to account for fluctuations in the market. If we were devote the entire 12.4 percent payroll tax rate to a funded system, the level of retirement, survivors, and disability benefits would be substantially higher than those produced by the current program. Many workers, particularly those with shorter life expectancies, would prefer greater consumption opportunities during their working lifetimes to the higher level of retirement income such a program would provide.

At the same time, more funding—that is more saving today—requires more forgone consumption today. Even assuming the transition is financed from current government expenditures, the public has substantial sentimental and personal interest attachments to many of these programs. Moreover, the further one moves from government expenditures at the margin toward the core functions of government, the higher the presumed return on those programs and the greater the cost to present generations of giving them up.

If the goal of a personal account is merely to fill the gap between Social Security's promised and payable benefits, then an account can be smaller still. However, while a relatively small account may fill this gap, its long-term benefits are also proportionately smaller.

What to Fund

It is possible to go almost all the way through the analytical framework with no significant mention of personal retirement accounts. The reason is that the economic case for a funded Social Security system has little to do with accounts per se, and the public debate over the costs and benefits of funding can take place outside of the personal account context. Even among account opponents there is a clear preference for funding over pay-as-you-go financing. For instance, the Clinton administration's Social Security proposals, first to invest the trust fund in the stock market and later to prefund through debt reduction, both acknowledge the case for a funded pension system.

On a permanent basis, however, there are only two viable ways to fund Social Security. Debt reduction is not one of them. Although it has the same economic effects as other means of funding, there is only a limited amount of publicly held debt to reduce. Any large-scale movement toward funding would soon exhaust current supplies of debt to retire.[114] (No, it is not permissible to run up new debt for the purpose of repaying it later).

Hence, the realistic choices for a funded system are between centralized investment of the trust fund and decentralized investment through personal accounts. The advantages of centralized investing are reduced administrative costs and the spreading of investment risks away from retirees and onto taxpayers. That may be of value, since even under current demographic trends, the working population will always be larger than the retired population. Shifting investment risk onto the working public may encourage the retired or near-retired population to lobby for more aggressive investment policies than taxpayers would be wise to bear.[115]

The main disadvantage of centralized investing is that it risks political influence over capital markets. Commentators ranging from Al Gore to Alan Greenspan have argued that the dangers of political investing are simply too great to be risked. Gore, a former supporter of government investment, said, "The magnitude of the government's stock ownership would be such that it would at least raise the question of whether or not we had begun to change the fundamental nature of our economy. Upon reflection, it seemed to me that those problems were quite serious."[116]

Defenders of centralized trust fund investing insist that no firewall will be left unconstructed to safeguard the nation's stock and bond markets from politically influenced investing of trust fund reserves. That may be so at the beginning, but others may soon find it in their interests to leverage the equity power of trust fund investing to accomplish goals they see as worthwhile. Few firewalls cannot be breached if those assigned to preserve them are uncommitted to the task.

Indeed, overseas experience confirms these risks. A World Bank study of centralized investment of government pension reserves found that in most cases investment returns did not exceed those available from an ordinary bank savings account. The principal reason, the Bank found, is that investment decisions "are largely determined by the mandates and restrictions imposed on public pension fund managers. Asset allocation decisions are largely political and have little to do with any application of portfolio theory. In short, the problem is that investment policy is driven by political motives." Both Ireland and Canada began investing their Social Security funds passively but will soon begin active targeted investments in infrastructure and domestic industries, raising concerns that political concerns will trump the financial needs of pensioners.[117]

Personal accounts would largely bypass the risks of political influence, as workers would have the incentive to monitor the investment choices available to them and protest any manipulation of investment choices toward nonfinancial goals. Moreover, personal accounts, unlike central investing, give workers a true property right to their retirement savings. Individuals desiring low-risk investment choices could opt for government bonds, making their benefits truly backed by the full faith and credit of the United States. Younger workers could invest in equities or corporate bonds, according to their needs and their willingness to live with risk. Personal accounts could also benefit those who, having shorter life expectancies, do not fare as well in the current system in which benefits are effectively annuitized. Finally, as the commission pointed out, personal accounts carry significant nonfinancial benefits, entirely separate from the benefits they deliver. In testimony before the commission, Washington University professor Michael Sherraden summarized research on asset-holding that has been conducted using experimental Individual Development Accounts. Among the findings—

- Asset-holding has substantial positive effects on long-term health and marital stability, even when studies control for income, race, and education.[118]
- Among participants in trial programs of Individual Development Accounts, 84 percent feel more economically secure, 59 percent report being more likely to make educational plans, and 57 percent report being more likely to plan for retirement because they are involved in an asset-building program.[119]
- Individuals with investment assets, as well as their children, perform better on educational tests and reach higher educational attainment, even after accounting for income.[120]
- Single mothers and their children are less likely to live in poverty if the mother came from a family with asset holdings, even after controlling for education and socioeconomic status.[121]
- Saving patterns are passed on from parents to children; parents who save are more likely to have children who save, even after other factors are counted. Hence, asset holding could be a means to establish long-term patterns of greater saving.[122]
- Ninety-three percent of individuals with Individual Development Accounts say they feel more confident about the future and 85 percent more in control of their lives because they are saving. Approximately half of account-holders report that having accounts makes them more likely to have good relationships with family members, and 60 percent say that they are more likely to make educational plans for their children because they are greater saving.[123]

In this context, it is worth noting that the commission's Plans 2 and 3 deliberately established progressive personal accounts mostly to build savings and wealth most among those who currently have the least.

Opinions may differ, and policymakers and the public must make up their own minds in the course of the political debate, but the criteria outlined above establish a strong prima facie case for funded personal accounts as part of a larger Social Security reform package.

Appendix: Specifications of Commission Reform Models

	Model 1	Model 2	Model 3
	Personal Accounts		
Personal account size	2% of wages	4% of wages up to $1,000 annually (indexed annually to wage growth)	1% add-on contribution plus 2.5% of wages up to $1000 annually (indexed annually to wage growth)
Voluntary	Yes	Yes	Yes
Additional contributions required?	None; however, Plan 1 is a generic plan that can accommodate new contributions	None	1% of wages required to participate (subsidized through income tax system
Real return that makes individual better off with accounts than without (SS defined benefit offset rate).	3.5%	2.0%	2.5%
Accounts owned by participants?	Yes	Yes	Yes
Accounts can be bequeathed to heirs?	Yes	Yes	Yes
Participants can choose from a mix of low-cost, diversified portfolios?	Yes	Yes	Yes
Contributions and account earnings splitting in case of divorce?	Yes	Yes	Yes
	Traditional Social Security Benefits		
New minimum benefit	None	By 2018, a 30-year minimum-wage worker is guaranteed benefit equal to 120% of poverty level, indexed annually to inflation.	By 2018, a 30-year minimum-wage worker is guaranteed benefit equal to 100% of poverty level (111% a 40-year worker), indexed annually to wage growth.
Widow/widower benefits	No changes	Increased to 75% of couple benefits (vs. 50% to 67% today) for lower wage couples	Increased to 75% of couple benefits (vs. 50% to 67% today) for lower wage couples
Changes to growth rate of traditional	None specified	Indexed to inflation instead of wages starting for those turning 62 in 2009	Indexed to gains in average life expectancy (results in average annual growth of 0.5% over inflation)
Additional changes to traditional	None specified	None specified	• Reduce benefit for early retirement and increase benefit for late retirement. • Gradually decrease the upper bend point replacement rate from 15% to 10% starting in 2009.

Source: Excerpted from President's Commission to Strengthen Social Security, final report.

Appendix: System Financing

Summary Results: Fiscal Sustainability Assuming 2/3 Participation in Personal Accounts (PA)	Model 1[1]	Model 2	Model 3	Current Law
1. Expected personal account assets in 2075 ($PV[2] trillions)	$1.1	$1.3	$1.6	NA
2. Gain in total Social Security system assets at end of 2075				
(Increase in Trust Fund + Expected PA Assets; $PV trillions)	$0.5	$4.8	$5.0	NA
3. Reduction in cash flow requirements from general				
revenue relative to present law[3,4]	$1.7	$14.8	$11.3	$0.0
Reduction in 75-year total (Sum of annual amounts in $2001 trillions)	7.7%	68.1%	52.2%	0.0%
Percent reduction versus current law (in $2001)				
Reduction in 75-year total ($PVbillion/$trillions)	-$0.2	$2.3	$1.7	$0.0
Percent reduction versus current law (in PV)	-3.8%	45.0%	33.9%	0.0%
4. Social Security cash flow				
With dedicated general revenue (GR) transfers				
Cash flow positive by end of valuation window?	No	Yes	Yes[5]	No
Income Rate (including GR Transfer)-Cost				
Rate in 2075 (% of payroll)	-4.56	1.41	0.12[5]	-6.05
Without dedicated GR transfers[4]				
Cash flow positive by end of valuation window?	No	Yes	No	No
Income Rate (excluding GR Transfer) Cost Rate in 2075 (% of payroll)	-4.56	1.41	-0.75	-6.05
5. Improvement in Actuarial Balance over 75-year period				
Improvement with GR transfer (% of payroll)	-0.32	1.99	1.88	0
Percent improvement with GR transfer	-17%	107%	101%	
Improvement without GR transfer (% of payroll)[4]	-0.32	1.15	0.87[6]	0
Percent improvement without GR transfer	-17%	62%	47%	
6. Transition investment				
Assuming current law surplus not used for financing[7]				
$PV trillions	$1.1	$0.9	$0.4	
As % of GDP over years included in calculation	0.36%	0.49%	0.25%	
Includes current law surplus available for financing[8]				
$PV trillions	$0.7	$0.4	$0.1	NA
As % of GDP over years included in calculation	0.29%	0.33%	0.10%	NA

Source: President's Commission to Strengthen Social Security, final report.

1. Model 1 does not include additional transfers to maintain actuarial balance.
2. PV = present value.
3. Cash flow requirements include only general revenue required in any year to maintain solvency.
4. Taxes on benefits and on PRA distributions are treated as Social Security revenues, not general revenue.
5. Includes new dedicated sources of revenue.
6. Improvement in actuarial balance would be +1.50 percent of payroll if new dedicated sources of revenue are included.
7. Unified budget concept: Difference between income and cost of proposed model versus present law.
8. Reflects extent to which negative balance in any year is more negative than under current law.

Notes

1. Executive Order 13210, President's Commission to Strengthen Social Security, May 2, 2001.

2. Estelle James, *Averting the Old Age Crisis* (Oxford: Oxford University Press, 1994).

3. President's Commission to Strengthen Social Sec urity, interim report, August 2001. Hereinafter cited as interim report.

4. Henry J. Aaron, Alan S. Blinder, Alicia H. Munnell, and Peter R. Orszag, "Perspectives on the Draft Interim Report of the President's Commission to Strengthen Social Security," The Century Foundation Center on Budget and Policy Priorities, July 23, 2001, p. 3.

5. Interim report, p. 9.

6. Ibid., p. 32.

7. It is not wholly true to say that the worker-retiree ratio is fixed. Steps such as the scheduled increase in the normal retirement age should alter the ratio slightly in the program's favor, though such steps are also comparable to reductions in benefit payments at any given age.

8. Neil Howe and Richard Jackson, "What Happens to Benefits When Social Security Goes Bankrupt?" The Concord Coalition, April 19, 2000.

9. In practice, rather than reducing each check sent to beneficiaries, checks would be withheld until sufficient funds existed to pay "full" benefits; over the course of a year, however, total benefits received would be the same as if each monthly benefit had been reduced.

10. Henry Aaron, Alan Blinder, Alicia Munnell, and Peter Orszag, "Perspectives on the Draft Interim Report of the President's Commission to Strengthen Social Security," The Century Foundation and the Center on Budget and Policy Priorities, July 23, 2001, p. 3.

11. Robert T. Matsui, U.S. House of Representatives, Remarks from the Capital Hilton Hotel, Washington, July 24, 2001.

12. P. Mitchell Prothero, "Social Security Panel Draws Fire," United Press International, July 24, 2001.

13. See Dean Baker, "Defaulting on the Social Security Trust Fund Bonds: Winners and Losers," Center for Economic and Policy Research, July 23, 2001.

14. David M. Walker, Comptroller General of the United States, "Social Security and Surpluses: GAO's Perspective on the President's Proposals," February 23, 1999.

15. Henry Aaron, Alan Blinder, Alicia Munnell, and Peter Orszag, "Perspectives on the Draft Interim Report of the President's Commission to Strengthen Social Security," The Century Foundation Center on Budget and Policy Priorities, www.tcf.org, July 23, 2001, p. 3.

16. Alicia H. Munnell and R. Kent Weaver, "Social Security's False Alarm," *Christian Science Monitor*, July 19, 2001.

17. Henry Aaron, Barry Bosworth, and Gary Burtless, *Can America Afford to Grow Old?* (Washington: The Brookings Institution, 1988), p. 14. Emphasis added.

18. Aaron, Blinder, Munnell, and Orszag, p. 14.

19. Interim report, p. 17.

20. Eric Black, "Memo to My Editor; Re: Social Security, Politics and the Balanced Budget Amendment," *Minneapolis Star Tribune*, March 10, 1995, p. 14A.

21. Byron Dorgan and Kent Conrad, "Unfair Looting," *Washington Post*, March 16, 1995, p. A21.

22. General Accounting Office, *Social Security: The Trust Fund Reserve Accumulation, the Economy, and the Federal Budget*, Washington, January 1989, p. 6. Emphasis added.

23. Statement of Charles A. Bowsher, Comptroller General of the United States, before the Senate Committee on Finance, "The Question of Rolling Back the Payroll Tax: Unmasking the Deficit Illusion," February 5, 1990.

24. Ibid., pp. 6, 8.

25. "Warning Issued by GAO about Social Security," *St. Louis Post-Dispatch*, January 29, 1989, p. 1A.

26. Alicia Munnell, "At Issue: Social Security and the Budget," *Fiscal Policy Forum* 4, no. 1 (Winter 1986). Emphasis added.

27. However, regression analysis of Social Security surpluses and on-budget expenditures from 1979 to 2001 indicate that improvements in Social Security cash balances are more than offset by reductions in non-Social Security surpluses. See Kent Smetters, "Has Mental Accounting Been Effective in 'Lock-Boxing' Social Security's Assets? Theory and Evidence," University of Pennsylvania and National Bureau of Economic Research, August 2001.

28. Bob Graham and Robert Matsui, "Social Security Safeguard," *Washington Times*, September 12, 1990, p. G3.

29. Robert Matsui, Testimony submitted to the President's Commission to Strengthen Social Security, August 15, 2001.

30. Robert Matsui, press release, "Trustees' Report Shows Social Security Health Improving," March 26, 2002.

31. Stephen C. Goss, chief actuary, and Alice H. Wade, deputy chief actuary, "Estimates of Financial Effects for Three Models Developed by the President's Commission to Strengthen Social Security," Memorandum dated January 31, 2002, pp. 23–24.

32. Office of Rep. Robert Matsui, constituent newsletter, Summer 2000.

33. Henry Aaron, "Costs of an Aging Population: Real and Imagined Burdens of an Aging America," in ed. Henry Aaron, *Social Security and the Budget* (Lanham, Maryland: University Press of America, 1988), p. 57. Emphasis added.

34. Henry Aaron, Barry Bosworth, and Gary Burtless, *Can America Afford to Grow Old?* (Washington: The Brookings Institution, 1988), pp. 7, 11. Emphasis added.

35. Alicia Munnell and C. Nicole Ernsberger, "Public Pension Surpluses and National Saving: Foreign Experience," *New England Economic Review*, March/April 1989.

36. Alicia Munnell and Lynn Blais, "Do We Want Large Social Security Surpluses?" *New England Economic Review*, September/October 1984. Emphasis added.

37. Pat Wechsler, "Will Social Security Be There for You?" *Newsday*, January 14, 1990, p. 79.

38. James Buchanan, "The Budgetary Politics of Social Security," in ed. Carolyn L. Weaver, *Social Security's Looming Surpluses: Prospects and Implications*, (Lanham, Maryland: University Press of America, 1990).

39. Alan Blinder, "The Budgetary Politics of Social Security," in Weaver, 1990. Disagreeing with Buchanan, Blinder argued that Trust Fund decumulations post-2016 would have an equal and opposite effect on government spending, reducing it to less than it would otherwise be. The commission's interim report notes this possibility and outlines the degree of spending restraint that would be required under such a scenario.

40. Peter Orszag, testimony to the Social Security Subcommittee of the House Ways and Means Committee, "Global Aging and Social Security Crises Abroad," September 21, 2000. See also, Peter R. Orszag and Joseph E. Stiglitz, "Rethinking Pension Reform: Ten Myths about Social Security Systems," presented at the World Bank Conference, *New Ideas about Old Age Security*, September 14–15, 1999.

41. Ibid. Emphasis added.

42. Steve Gerstel, "Senate Begins Debating $1.1 Trillion Fiscal 1990 Budget," United Press International, May 2, 1989.

44. Leo Fitzmaurice, "Republicans Masking Deficit, Gephardt Says," *St. Louis Post-Dispatch*, February 13, 1990, p. 10A.

44. But they must first devise a way for Social Security to truly save these funds rather than merely crediting them to the trust fund and transferring them to general revenue to be spent.

45. For instance, an August 2, 1999, Zogby International poll asked, "If Social Security funds are invested in stocks and bonds, who should do the investing—the government through a central fund, or individual workers through private accounts like an IRA or 401(k)?" Respondents favored private accounts by a more than four-to-one margin. A January 25–27, 2002, CNN/USA/Gallup Today poll showed that, by a margin of 63 to 33 percent, respondents favor the option to invest part of their payroll taxes in a personal retirement account, despite a lengthy period of low market returns.

46. Peter Coy, "Who Loses under Social Security Reform?" *Business Week Online*, December 19, 2001.

47. Alan L. Gustman and Thomas L. Steinmeier, "How Effective Is Redistribution under the Social Security Benefit Formula?" *Journal of Public Economics* 82, no. 1 (October 2001): 1–28.

48. See Julia Lynn Coronado, Don Fullerton, and Thomas Glass, "The Progressivity of Social Security," *National Bureau of Economic Research*, March 2000.

49. See Gregory Pappas, Susan Queen, Wilbur Hadden, and Gail Fisher, "The Increasing Disparity in Mortality between Socioeconomic Groups in the United States, 1960 and 1986," *New England Journal of Medicine* 329 (July 8, 1993): 103–109.

50. U. S. Bureau of the Census, *Current Population Reports*, Series P20-514; *Marital Status and Living Arrangements: March 1998 (Update)*; and earlier reports.

51. This could happen in two ways: by working part time or by withdrawing entirely from the workforce for a time. In either case, Social Security's benefit formula has difficulty distinguishing between those who worked full time at low wages and those

who worked part time at high wages. For instance, Ms. Smith is a single mother who works full time at half the average wage ($15,000) while simultaneously raising her children. Ms. Jones is married and worked for nine years at twice the average wage ($60,000) before leaving work to raise her children. At retirement, these two very different women would receive similar benefits—about $620 per month. Even though Ms. Smith worked full time at low wages and Ms. Jones part time at high wages, their average wage—upon which their benefits are based—is the same. And because that average is low, both benefit from Social Security's "progressivity" even if only one actually needs it.

52. Alan L. Gustman and Thomas L. Steinmeier, "How Effective Is Redistribution under the Social Security Benefit Formula?" National Bureau of Economic Research Working Paper no. 7597, March 2000, p. 33.

53. Peter Coy, "Who Loses under Social Security Reform?" *Business Week Online,* December 19, 2001.

54. As defined by the Social Security Administration, a low-wage worker receives 45 percent of the average wage, while a high-wage worker receives 160 percent of the average wage.

55. Interim report, p. 26.

56 Orlo R. Nichols, Michael D. Clingman, and Milton P. Glanz, "Internal Real Rates of Return under the OASDI Program for Hypothetical Workers," Social Security Administration, Office of the Chief Actuary, Actuarial Note no. 144, June 2001.

57. Robert L. Clark, Gordon P. Goodfellow, Sylvester J. Schieber, and Drew A. Warwick, "Making the Most of 401(k) Plans: Who's Choosing What and Why," in ed. Olivia S. Mitchell, P. Brett Hammond, and Anna M. Rappaport, *Forecasting Retirement Needs and Retirement Wealth* (Philadelphia: University of Pennsylvania Press, 2000), pp. 95–138.

58. The commission recommended, "personal account distributions should be permitted to be taken as an annuity or as gradual withdrawals, and balances above a threshold can also be taken as a lump-sum distribution. The threshold amount should be chosen so that the yearly income received from an individual's defined benefit plus the joint (if married) annuity keeps both spouses safely above the poverty line during retirement, taking into account expected lifetimes and inflation." Final report, pp. 41–42. Some account critics charge that requirements to annuitize eliminate the possibility of wealth building and bequests, popular features of personal accounts. (See, for example, Bernard Wasow, "Setting the Record Straight: Two False Claims about African Americans and Social Security," The Century Foundation, March 2002, p. 2. The increased poverty protections incorporated into the traditional program as part of Plans 2 and 3, however, mean that relatively small fractions of the account balance would be required to be annuitized to maintain an income above the poverty line, thus enabling retirees to leave lump sums to their heirs. Moreover, account balances of workers who die before retirement could also be passed on, which is of considerable value to groups with shorter life expectancies.

59. Whereas the current Social Security program offers a de facto inflation-adjusted annuity, which is often touted as superior to anything the market could provide, private inflation indexed annuities are now on the market. Moreover, there is evidence that individuals would prefer variable annuities that invest in equities to real, inflation-indexed annuities. See Jeffrey R. Brown, Olivia S. Mitchell, James M. Poterba, "The Role of Real Annuities and Indexed Bonds in an Individual Accounts Retirement Program," in ed. Zvi Bodie, P. Brett Hammond, and Olivia S. Mitchell, *Innovations in Financing Retirement* (Philadelphia: University of Pennsylvania Press, 2002), pp. 175–97.

60. For instance, assume that a worker invested the maximum of $1,000 annually into his or her personal account. Compounding these contributions at 2 percent would total $60,644 after 40 years, and computing this notional lump sum through an annuity formula would reduce traditional benefits by approximately $360 per month. However, the true account balance, growing at an assumed interest rate of 4.6 percent, would equal $112,265—an amount sufficient to increase monthly benefits by $672. Again, as long as the account's interest rate exceeds the offset interest rate, total retirement benefits will increase.

61. Final report, p. 98

62. Ibid., p. 113.

63. See Henry J. Aaron, Alan S. Blinder, Alicia H. Munnell, and Peter R. Orszag, "Governor Bush's Individual Account Proposal: Implications for Retirement Benefits," The Century Foundation Issue Brief no.11, June 2000.

64. This amount would be 88 percent of what Social Security promises but cannot pay. With a net return of around 4.2 percent, the 2042 retiree could receive more than his promised benefit.

65. *Flemming v. Nestor,* 363 U.S. 603 (1960).

66. If payroll tax shortfalls were financed through income tax revenues, rates would have to rise by approximately 17 percent across the board by 2052. If income tax increases were restricted to upper rates, the

increases would be even larger. See Andrew G. Biggs, "The Cost of Not Reforming Social Security," *The Dismal Scientist*, April 17, 2001, www.Economy.com.

67. Author's calculations.

68. For discussion of differential mortality according to income, see Eugene Steuerle and Jon M. Bakija, *Retooling Social Security for the 21st Century: Right and Wrong Approaches to Reform*, (Washington: Urban Institute Press, 1994), pp. 115–119.

69. Interim report, p. 13.

70. The latest report from Social Security's trustees illustrates this point, albeit on a smaller scale. The trustees increased their projections for future productivity growth, but this had little effect on system solvency and, overall, the program's actuarial balance declined and its long-term deficits increased.

71. In practice, there are several means to accomplish price indexing. Under the commission's Plan 2, price indexing would actually be implemented by multiplying the PIA bend point factors (i.e., 90, 32, and 15 percent replacements) by the ratio of the Consumer Price Index to the Average Wage Index in successive years. The bend point dollar amounts would remain indexed to wages. By indexing the factors rather than the dollar amount, the progressivity of the benefit formula is retained. If the bend point dollar amount were indexed to prices, over time retirees would see practically all of their preretirement wages covered under the 15 percent bend point, creating a de facto flat replacement rate throughout the income distribution.

72. In other words, a worker retiring just after 2009 would have his working years before 2009 calculated under the old system, with only years past 2009 calculated under the new formula.

73. Kilolo Kijakazi and Robert Greenstein, "Replacing 'Wage Indexing' with 'Price Indexing' Would Result in Deep Reductions over Time in Social Security Benefits," Center on Budget and Policy Priorities, December 14, 2001.

74. Replacement rates would also fall for workers with wage levels derived from the average in any given year. The Social Security Administration's "low-wage" earner, for instance, is defined as earning 45 percent of the average wage, whatever that average wage may be.

75. Assuming an all-bond portfolio, the replacement rate would be approximately 29.4 percent, while with a 60-40 stock bond portfolio it would be approximately 36 percent.

76. Greenstein and Kijazaki, p. 6.

77. This, of course, is untrue when benefits from the personal accounts are counted in. All workers would receive more than the current system can pay, and many low-wage workers would receive more than is even promised.

78. Their position is valid only when workers' economic well-being is judged not by their absolute incomes but by their incomes relative to others. In this sense, the low-wage worker in 2070 will be disadvantaged in a way that an average-wage worker today is not, despite their having virtually identical incomes.

79. Testimony of Hans Riemer before the President's Commission to Strengthen Social Security, August 22, 2001, www.csss.gov, p. 27.

80. Peter Diamond, James Hickman, William Hsiao, and Ernest Moorhead, "Report of the Consultant Panel on Social Security to the Congressional Research Service," August 1976, p. 23.

81. Ibid., p. 9.

82. Peter Diamond, James Hickman, William Hsiao, and Ernest Moorhead, letter to the *New York Times*, May 29, 1977, sec. 4, p. 14.

83. "Propping up Social Security," *Business Week*, July 19, 1976, p. 34.

84. Statement of Henry Aaron, Gardner Ackely, Mary Falvey, John Porter, and J. W. Van Gorkom, *Social Security Financing and Benefits, Report of the 1979 Advisory Council* (Washington: Government Printing Office, 1979), pp. 212–15.

85. "Will Voluntary Personal Accounts Save Social Security?" American Enterprise Institute Seminar Series in Tax Policy, April 5, 2002.

86. For instance, the wage indexing plan advocated by the Ford administration implied system costs in 2030 of 18.9 percent of payroll, contrasted with 17.24 percent projected in the 2002 Social Security trustees report. The Hsaio panel faulted the Ford administration's plan for leaving "a significant actuarial deficit in the financing of the OASDI system" and highlighted "the stability of the tax rates needed to finance promised benefits under this Panel's recommendation—a stability not enjoyed by other major recommendations that Congress is considering." *Report of the Consultant Panel on Social Security to the Congressional Research Service*, p. 6.

87. See Michael Sherraden, "Saving in IDA Programs: Supplement to Invited Testimony to the President's Commission on Social Security," October 28, 2001, p. 1, which noted that even with a 2-to-1 match, participants contributed to their accounts an average of only 7 out of 12 months of

the year and saved only 67 percent of the maximum eligible for the match.

88. 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, www.ebri.org/rcs/T114.pdf.

89. Hans Riemer, "Bush Social Security Commission Proposes Benefit Cuts to Pay for Privatization," Institute for America's Future, December 6, 2001.

90. Testimony of Roger Hickey before the President's Commission to Strengthen Social Security, September 6, 2001, p. 226, www.csss.gov. Hickey cited the Aaron-Reischauer proposal as one of several plans he approved of that reached actuarial balance "without privatizing and without across-the-board benefit cuts or tax hikes" (p. 204). On being reminded that the Aaron-Reischauer plan increased the retirement age Hickey declared his opposition to that provision, but fully 38 percent of the plan's progress toward solvency is achieved through changes in the retirement age. Aaron-Reischauer also contains another across-the-board benefit cut in the form of an increase in the benefit computation period from 35 to 38 years, which constitutes another 13 percent of the plan's progress toward solvency. See Henry J. Aaron and Robert D. Reischauer, *Countdown to Reform: The Great Social Security Debate*, the Century Foundation Press, New York, 2001.

91. Staff of Robert Matsui, U.S. House of Representatives, "Six Problems with Privatizing Social Security," March 6, 2002.

92. Interim report, p. 138; emphasis in original.

93. Social Security Advisory Board, "Charting the Future of Social Security's Disability Programs: The Need for Fundamental Change," January 2001, p. 11.

94. Ibid., p. 11.

95. Ibid., p. 5.

96."Administrative Expenses as a Percentage of Contribution Income and of Total Expenditures, Fiscal Years 1996–2000," Table III.A8 of the *2001 OASDI Trustees Report.*

97. Robert A. Rosenblatt, "Options Given to Save Social Security; Privatization: Panel Will Let President Bush Choose among Varied Plans to Restore Retirement Program to Solvency," *Los Angeles Times,* November 30, 2001.

98. Roger Hickey, Testimony before the President's Commission to Strengthen Social Security, p. 204.

99. Peter Diamond, Remarks at "Will Voluntary Personal Accounts Save Social Security?" American Enterprise Institute Seminar Series in Tax Policy, Friday, April 5, 2002.

100. On the effect of economic growth on system solvency see Andrew G. Biggs, "Social Security: Is It 'A Crisis That Doesn't Exist'?" the Cato Institute, Social Security Privatization Paper no. 21, October 5, 2000.

101. Hans Riemer, "Young Social Security Beneficiaries in the 50 States," 2030 Center, October 2, 2000, p. 5.

102. Hans Riemer, testimony before the President's Commission to Strengthen Social Security, October 18, 2001, p. 44ff.

103. Individuals who pay into a funded system for only part of their working lifetimes would, of course, still receive proportionate benefits at retirement.

104. See Paul A. Samuelson, "An Exact Consump-tion-Loan Model of Interest with or without the Contrivance of Money," *The Journal of Political Economy,* December 1958, pp. 467–482; Henry J. Aaron, 1966. "The Social Insurance Paradox," *Canadian Journal of Economics and Political Science,* vol. 32, no. 3. In practice, Social Security's pay-as-you-go return is slightly lower than the sum of its two components because the number of hours worked generally declines over time.

105. James Poterba, "The Rate of Return to Corporate Capital and Factor Shares: New Estimates Using Revised National Income Accounts and Capital Stock Data," National Bureau of Economic Research, April 1999, pp. 9–10. The standard deviation of returns on capital was 1.0 percent.

106. If the return to capital were lower than the pay-as-you-go return (a so-called "dynamically inefficient" economy), all generations would bene-fit by funding present consumption on a pay-as-you-go basis until such time as the capital stock were depleted sufficiently to raise the return from capital above the pay-as-you-go rate. This was the case in Canada during the 1960s when it established its pay-as-you-go pension program, though even then such a circumstance could not be expected to long continue. For the United States to reach dynamic inefficiency would require a national saving rate of approximately 30 percent, significantly above the present level. Countries with extremely high saving rates could theoretically benefit from pay-as-you-go financing, though only the highest saving countries such as Singapore could possibly qualify and globalized capital markets make such benefits even less likely. See, for example, Kenneth Kassa, "Does Singapore Invest Too Much?" *Economic Letter,* Federal Reserve Bank of San Francisco, May 15, 1997. Of course, this analysis leaves aside other aspects of reform, such as risk and

ownership, which would also play into any decision.

107. See Peter A. Diamond, "National Debt in a Neoclassical Growth Model." *American Economic Review* no. 55, 1965, pp. 1126–1150.

108. The distinction between the real, pre-tax return to capital and the returns to investment accounts is most commonly made by Martin Feldstein; see "The Missing Piece in Policy Analysis: Social Security Reform," The Richard T. Ely Lecture, *American Economic Review* 86, no. 2 (May 1996): pp. 1-14. Feldstein points out that while the individual receives the return to his investment only after state, local, and federal corporate taxes have been paid, the real return to new capital investment is in fact the pre-tax return to capital. Some Social Security reform plans attempt to "capture" that full return by estimating the amount of new saving the plan would create, deriving the increased federal corporate tax revenues based on that new saving, and crediting those new revenues to Social Security.

109. This is complicated somewhat in that Social Security currently runs payroll tax surpluses. Although these surpluses are credited to the trust fund, many analysts (as detailed above) believe they are not contributing to national saving.

110. However, if post-1983 payroll tax surpluses were consumed, then taxpayers during that period enjoyed more government services or lower taxes than they would have had those surpluses been saved. Moreover, future workers will earn lower wages than if the surpluses had been saved. In this case, future workers could argue with past workers that they were not provided with the economic means to finance full promised benefits.

111. Over the long term, however, an economy with a higher rate of saving will in general also have a higher rate of consumption, up to the so-called "golden rule" level of saving.

112. There are, of course, other reasons for moving to a personal account–based pension system, such as personal ownership, control over investments, and the ability to pass investments on to an heir. These reasons could make the transition worthwhile even if debt financing were involved.

113. Paul Evans and Gregorios Karras, "Are government activities productive? Evidence from a panel of U.S. States," The Review of Economics and Statistics 76, no. 1, February 1994, pp. 1-11. See also, Dogulas Holtz-Eakin, "Public Sector Capital and the Productivity Puzzle," Review of Economics and Statistics 76, no. 1, February 1994, pp. 12–21.

114. See General Accounting Office, *Federal Debt: Debt Management Actions and Future Challenges,* GAO-01-317 (Washington: Government Printing Office, February 28, 2001).

115. On the risk-related costs of centralized investment, see George M. Constantinides, John B. Donaldson, and Rajnish Mehra, "Junior Must Pay: Pricing the Implicit Put in Privatizing Social Security," National Bureau of Economic Research Working Paper no. 8906, April 2002.

116. Richard W. Stevenson and James Dao, "Gore Defends Stock Investment Switch," *The New York Times,* May 25, 2000, p. 27.

117. Canadian Chamber Of Commerce, "Canada's Retirement Income System: Still in Need of Reform," February 2002; and Philip Lane, "Gambling with the Future of Our Pensioners," *The Irish Times,* February 12, 2002.

118. R. J. Galligan and S. J. Bahr, "Economic Well-Being and Marital Stability: Implications for Income Maintenance Programs," *Journal of Marriage and the Family*, 1978, pp. 283–290; Hampton, R. L., "Family Life Cycle, Economic Well-Being and Marital Disruption in Black Families," *California Sociologist* 5, 1982, pp. 16–32; and S. J. South and G. Spitze "Determinants of Divorce over the Marital Life Course," *American Sociological Review* 51, no. 4 (1986): 583–590.

119. A. Moore, S. Beverly, M. Schreiner, M. Sherraden, M. Lombe, E. Cho, L. Johnson, and R. Vonderlack, *Saving, IDA Programs, and Effects of IDAs: A survey of Participants. Downpayments on the American Dream Policy Demonstration: A National Demonstration of Individual Development Accounts,* Washington University in St. Louis, George Warren Brown School of Social Work, Center for Social Development, 2001.

120. S. Mayer, *What Money Can't Buy: Family Income and Children's Life Chances* (Cambridge, Massachusetts: Harvard University Press, 1997); M. S. Hill and G. J. Duncan, "Parental Family Income and the Socioeconomic Attainment of Children," *Social Science Research* 6 (1987): 39–73.

121. L. Cheng, "Asset Holding and Intergeneration-al Poverty Vulnerability in Female-Headed Families," Paper presented at the Seventh International Conference of the Society for the Advancement of Socio-Economics, Washington, April 7–9, 1995.

122. M. E. Pritchard, B. K. Meyers, and D. Cassidy, "Factors Associated with Adolescent Saving and Spending Patterns," *Adolescence* 24, no. 95 (1989): 711–723.

123. Moore et al., *Saving, IDA Programs, and Effects of IDAs.*