

One Actuary's Critique

BY RON GEBHARDTSHAUER

Do Bush's and Gore's proposals really solve Social Security's financial problems? They both want to "save Social Security," but both leave the details to others. That's understandable of course. Tough decisions for fixing the system don't get people elected President.

BUT WE, THE VOTERS, AREN'T PURE EITHER. None of the fixes (cutting benefits, increasing taxes, and/or raising the retirement age) are painless, and we want a painless solution, which is why everyone is talking about individual retirement accounts. But they don't fix Social Security.

Both candidates agree on creating individual accounts (IAs). Bush diverts some of our current Social Security taxes to an IA (he calls it a PRA), which means that he must reduce the portion that comes from the Social Security trust funds. Gore doesn't want to cut the guarantees, so he adds a voluntary IA on top of Social Security (he calls it a Social Security-Plus Account or SSPA) and provides a progressive government match to encourage contributions from low-income people.

Bush's Proposal: Bush provides the following principles for reform (with his words in quotes).

■ No changes "for those now retired, or nearing retirement." (They've suggested age 50 and over). Does that mean that Bush won't touch their COLAs? I think his words imply that and I'll bet that's what most retired people will think. Thus, this older group (who got the greatest returns on their SS contributions) won't be a part of the solution. That means bigger fixes will have to fall on younger people, who already have a worse return on Social Security than their parents.

■ "All Social Security funds... dedicated to Social Security." Bush says he locks away more than \$2 trillion for Social Security over the next 10 years. However, he uses \$1 trillion of it for his PRAs. That is why Social Security's key problem dates come much sooner. The 2015 date when outgo exceeds income moves up to 2003 (which is why we will return to budget deficits real soon). The 2037 date when Social Security assets are exhausted moves up to 2023.

■ "The payroll tax must not be raised." This means Social Security's guaranteed benefits have to be cut and/or the retirement age must be increased and/or deficits will increase (which means that we give the bill to our kids).

■ Reform includes PRAs for young people... in reliable funds,... and only for retirement or inheritance. If, as Bush suggests, only a few investment funds will be available, then the government will be involved in selecting the investments. What if the funds aren't doing well when you retire? Will individuals sue the government or demand expensive guarantees?

Bush notes that the Social Security system gets only a 2 percent real rate of return, while investments in the PRAs will earn 6 percent real returns. This is a misleading comparison. Social Security invests in Treasury bonds, which currently earn a 5 percent real return. Its ultimate returns for us are not as good because we gave more of our payroll taxes to our parents than we will get from our kids, and that

will also be true for a system that includes PRAs. If Social Security and/or PRAs were to invest in stocks, and get better returns, we could pay ourselves larger Social Security/PRA benefits, but then other parts of society would get less of the total pie. Giving better returns to Social Security (and people with PRAs) may be a better way of distributing our production, but it'll reduce what others get.

Gore's Proposal: Gore provides the following principles for reform:

■ Gore would create individual retirement accounts on top of Social Security—his SSPAs. The government would provide a progressive match to encourage contributions and avoid the problem of small accounts having expenses larger than their investment yields for many years.

Couples earning less than \$30,000 would get a 3 for 1 match. Couples earning between \$30K and \$60K would get a 1 for 1 match. Couples earning between \$60K and \$100K would get a 1 for 3 match. The total contribution could be at most \$4,000 for couples and \$2,000 for singles.

My guess is that only 10 percent to 20 percent of the match money will go to the intended target—people earning below \$30,000, because it's difficult for them to find the money to contribute. In addition, Gore's SSPA proposal would be expensive, up to about \$50 billion per year. Gore would allow savings to be withdrawn for the same reasons as IRAs (a first home, major medical expenses, and college expenses). That encourages people to contribute but the funds may not all go to retirement.

■ Gore's proposal improves Social Security's benefits to widows and mothers, who currently get smaller benefits on average. However, the improvement for mothers may not go to its intended recipients (low-income mothers), and Gore hasn't suggested any revenue to pay for the two improvements (about ? percent of payroll).

Some of Social Security's financial problems aren't really Social Security's problem. They were caused by our huge borrowing in the past, including borrowing from Social Security. Not only do we owe \$3 trillion in public debt to ourselves, we have another \$2 trillion in gross debt (half of which is owed to Social Security's trust fund).

Thus, Gore suggests paying down the debt in good times. This reduces the government's interest payments. Gore would give those savings to Social Security (but some people have concerns with general revenue financing). It also makes it easier to pay Social Security's benefits in the future.

Both Gore and Bush would have individual accounts with Social Security, Bush's has a carve-out, Gore's has an add-on. You have to decide how much corporate responsibility/risk-taking versus individual responsibility/risk-taking we need. Maybe there's a compromise: a 1 percent add-on plus a 1 percent carve-out.

Now that we've got that solved, let's get back to fixing Social Security's financial problem. In fact, we should probably do that first. ●

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