RETIREMENT SECURITY

More than 30 million Americans depend on Social Security to provide a significant share of their retirement income. Since the program was enacted in 1935, it has served as a vital piece of the "three-legged stool" of retirement security, which today includes employer-provided pension plans and personal savings. Still, President Roosevelt himself viewed Social Security as an *evolving* program. As he wrote in a 1939 message to Congress: "We shall make the most orderly progress if we look upon Social Security as a development toward a goal rather than a finished product. We shall make the most lasting progress if we recognize that Social Security can furnish only a base upon which each one of our citizens may build his individual security through his own individual efforts." (Cited by the Historian's Office of the Social Security Administration, May 1996). In this regard, Social Security is one critical, if unfinished, piece of the retirement security safety net for seniors – especially those with limited incomes.

That evolution must continue today, because Social Security as currently structured is going bankrupt and cannot fulfill its promises to future retirees. Without reform, future retirees face benefit cuts of up to 22 percent in 2041. Attempts to fix the problem without fundamental reform will excessively burden future workers and sacrifice U.S. prosperity.

Further, even if the current system could be sustained, it is no longer a good deal for American workers. The real rate of return for current workers is only about 1 percent to 2 percent, and the expected rate of return for today's children is expected to fall below 1 percent. By comparison, even through periods of economic downturn, the average rate of return of the stock market has been at least 7 percent. As discussed in a previous section, the current system also unfairly discriminates against minorities and women who work outside the home.

Social Security's shrinking value and fragile condition pose a serious problem that threatens to break the broader compact in which workers support the generation preceding them, and earn the support of those who follow. To maintain the program's significant role as a part of the retirement security safety net, the share of future retirees' income promised by Social Security must be fulfilled somehow. The legacy envisioned by President Roosevelt must be completed without bankrupting future workers.

This proposal addresses the shortcomings of the current system and strengthens the retirement safety net by providing workers with the voluntary option of investing a portion of their FICA payroll taxes into personal savings accounts. Due to the higher rate of return received by investments in secure funds consisting of equities and bonds, these accounts would allow workers to build a significant nest egg for retirement that far exceeds what the current program can provide. Each account will be the property of the individual, and fully inheritable, which will allow workers to pass on their prosperity to their descendants.

Individuals over 55 will remain in the current system and will not be affected by this proposal in any way: they will receive the benefits they have been promised, and have planned for, during their working years. All other workers will have a choice to stay in the current system or begin contributing to personal accounts. Those who choose the personal account option will have the opportunity to begin investing a significant portion of their payroll taxes into a series of funds managed by the U.S. government. The system closely resembles the investment options available to Members of Congress and Federal employees through the Thrift Savings Plan [TSP]. As these personal accounts continue to accumulate wealth, they will eventually replace the funding that comes through the government's pay-as-you-go system. This will reduce the demand on government spending, lead to a larger overall benefit for retired workers, and restore solvency to the program.

As with Medicare, the Social Security component of this plan will make the program sustainable for the long run. It will do so without overtaxing future workers and crippling the economy. Based on estimates by the Social Security actuary, the program will be solvent with permanent and growing surpluses by 2066. Finally, it will allow hard-working Americans to accumulate more than $10 trillion in their accounts by 2040, all money which they can pass on to their heirs.

In addition, the creation of personal investment accounts for future retirees will provide additional capital stock for the U.S. economy, increasing the potential for growth. This will be especially important in coming decades in helping compensate for the projected slowdown in labor force growth, a key component to increases in GDP.

Guarantee of Benefits. Individuals who choose to invest in personal accounts will be ensured that their total benefits are at least as large as the benefits would be if they decided to remain in the current system. If an individual's personal account is too small to provide a monthly annuity payment equal to this level, the government will make up the difference.

Personal Choice in Retirement Accounts. Beginning in 2011, the proposal allows each worker younger than 55 to shift a portion of his or her Social Security payroll tax payment into a personal retirement account, chosen from a group of investment funds approved by the government (see below). When fully phased in, the personal accounts will average 5.1 percentage points of the current 12.4-percent Social Security payroll tax.

The personal investment component is phased in to allow a smooth transition. Initially, workers are allowed to invest 2 percent of their first $10,000 of annual payroll into personal accounts, and 1 percent of annual payroll above that up to the Social Security earnings limit. The $10,000 level will be constantly indexed for inflation. After 10 years, the amount that workers can invest will be increased to 4 percent up to the inflation-adjusted level, and 2 percent above that. After 10 more years, these amounts will be increased to 6 percent and 3 percent. Eventually, by 2041, workers will be able to invest 8 percent up to the inflation-adjustment level, and 4 percent of payroll above that, for an account averaging 5.1 percent.

The choice of personal retirement accounts is entirely voluntary. Even those under 55 can remain in the current system if they choose. Further, those who choose to enter the personal account system also have an opportunity to leave the system, and those who initially opt out of the system of personal accounts can enter into it later on.

Property Right. Each personal account is the *property* of the individual, and the resources accumulated can be passed on to the individual's descendants. This contrasts with current government Social Security benefits, which are subject to reductions or other changes by Congress, and which cannot be passed on. Benefits are tilted in favor of low-income individuals who do not have disposable income to invest. As a result, these individuals will be able to join the investor class for the first time. As Social Security benefits become an individual's property, the government no longer will be able to raid this money to pay for spending on other programs.

Soundness of Accounts. Those who choose the personal account option will select from a list of managed investment funds approved by the government for soundness and safety. After an account reaches a low threshold, a worker will be enrolled in a "life cycle" fund that automatically adjusts the portfolio based on age. A worker may continue with the life cycle option or choose from a list of five funds similar to the TSP options. After workers accumulate more than $25,000 in their account, they can choose to invest in additional nongovernment options approved by the Personal Social Security Savings Board.

Protection for Current Retirees and Those Nearing Retirement. As with Medicare, this plan recognizes the obligation to preserve the existing Social Security Program for those who already are retired, and for those near retirement who have planned on its benefits for most of their working lives. Therefore, persons now retired and receiving Social Security benefits, and those over 55 at the time of implementation, will remain in the existing system and will receive their promised benefits. Their benefits will in fact be more secure because the transformation of the program, along with other reforms in this proposal, ensures the Federal Government will be able to pay promised benefits.

Enhanced Benefits for Low-Income Americans. Low-income Americans are likely to benefit most from the personal account arrangement, should they choose it. They will have an unprecedented opportunity to join the investor class and increase their personal wealth, and also will be allowed to have larger personal accounts than others. Further, both those who remain in the current system, and those who opt for personal savings accounts, will receive increased benefits if they meet certain working requirements. All individuals in the traditional system who meet these requirements will be ensured that their minimum benefits are equal to at least 120 percent of poverty, an improvement from current law. Those in the personal account system will be guaranteed a minimum of at least 150 percent of poverty.

The use of progressive price indexing for lower-income workers (see below) will also allow the benefits of those who most need the safety net to grow faster than those who have greater means to provide for their retirement. These changes will ensure the system favors those individuals who are most reliant on it for support.

No Change for Survivors and the Disabled. Survivor and disability benefits will continue as under the current system unchanged.

Fiscal Sustainability. The plan makes adjustments in the determination of future initial Social Security benefits that will modernize the program, provide greater support for lower-income beneficiaries, and at the same time make the program's overall spending sustainable for the long run. This would continue to allow benefits to grow for those who remain in the current system. Further, it would only impact individuals under 55. In order to accomplish these objectives, the proposal uses progressive price indexing and modernizes the retirement age.

- *Progressive Price Indexing*. At present, an individual's initial level of Social Security benefits are based on the individual's average career earnings. To determine average career earnings, an individual's income from previous years is adjusted upward by the rate that average American wages have increased over time. This approach, called "wage indexing," exceeds the amount of initial benefit growth needed to keep pace with economic conditions, and contributes to the unsustainable projected burden on Social Security. An alternative approach is "progressive price indexing," which adjusts initial benefits according to the consumer price index, with enhanced benefits for lower-income workers.

  This reform, starting in 2016, employs a mix of wage indexing and "progressive price indexing" for initial Social Security benefits, which also will place the program on a sustainable fiscal and economic course. Individuals who make less than approximately $29,000 per year will continue to receive initial benefits based on wage indexing. Those who make between $29,000 and $113,000 (in 2016) will have their initial benefits adjusted upward by a combination of wage and price indexing that becomes more oriented toward price indexing as they move up the income scale. For example, an individual whose income is half way between roughly $29,000 and $113,000 will have his initial benefit adjusted upward approximately 50 percent by wage indexing and 50 percent by price indexing. Individuals making more than $113,000 will have their initial benefits adjusted upward by price indexing. These amounts will consistently be indexed for inflation.

  As a result, all future Social Security beneficiaries will see their benefits grow by an amount at least equal to inflation over time. The reform will not affect the cost-of-living adjustment that Social Security beneficiaries receive each year once they have begun receiving benefits.

  The use of progressive price indexing will peg the growth of future Social Security outlays to a realistic index of the cost of living, while rescuing the program from the insolvency that will otherwise occur.

- *Modernizing the Retirement Age*. When Social Security was enacted, the average life expectancy for men in America was 60 years; for women it was 64. Today, average life expectancy has increased to 75 years for men and 80 years for women (2007 figures). Life expectancies are expected to continue lengthening throughout the century.

  Given these facts, and the choice among many Americans to work additional years, this proposal extends the gradual increase in the retirement age, from 65 to 67, occurring under existing policies. Once the current-law retirement age reaches 67 in 2026, this proposal continues its progression in line with expected increases in life expectancy. This will have the effect of increasing the retirement age by 1 month every 2 years. The retirement age will still be under 70 years of age for nearly all of the 21st century.

The modernization of the retirement age will not affect the ability of an individual who chooses the personal account system to retire early, as long as his or her account has accumulated enough funds to provide an annuity equivalent to 150 percent of poverty.