Fix Social Security By Creating Own America Personal Accounts for All Workers

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Executive Summary

Democratic presidential candidates like Elizabeth Warren, Bernie Sanders and Cory Booker have made inequality a central issue in the campaign. But their plans for minimum-wage hikes, wealth taxes and income-tax rates of 50%-70% would restrain the economy and hurt all Americans.

This paper offers a simple solution to raise incomes and wealth of Americans of all income groups and one that will allow workers to become owners and grow their investment income. The main cause of income inequality is the lack of real wealth held by the bottom 50% of Americans in income. This group of Americans already have tight family budgets, and so the money to put in real savings in constrained. To alleviate this problem and to solve the long term unfunded liabilities of Social Security, Congress should amend the Federal Insurance Contributions Act tax to give every worker the option to shift up to 10% of his paycheck away from Social Security and into a new, personal "Own America Account." Each individually owned account would be invested in an index fund of roughly two-thirds stocks and one-third bonds, and would mature at the federal retirement age. This way, every working American—from the minimum-wage waiter to the truck driver to the store manager—would become a genuine owner, building real wealth for himself and his family with each paycheck.

Investment in the private market would deliver far better retirement savings than the current government-mandated structure. We estimate that over the past 40 years, Social Security's real annual return for a typical middle-class worker has been about 1% a year. And given the program's growing deficits, returns may be even lower or even negative for today's young workers. In contrast, stocks returned more than 6% annually in the same 40-year period.

Over a career of saving, the difference amounts to a literal lifetime's worth of additional income. This study (relying on an analysis from the nonpartisan Tax Foundation) finds that the average American who retired in 2016 after 40 to 45 years of work could have saved more than $1 million in balanced index accounts, and many middle-class families could have accumulated closer to $2 million.

To be sure, the stock market is risky and highly volatile in the short term, as tens of millions of Americans discovered painfully during the Great Recession. But over periods of 40 or 50 years the market offers remarkably stable and robust real returns of 6% or more—and that's been true since the New York Stock Exchange first opened its doors. With Own America Accounts, even stock and bond returns half as large as the historical average would still leave workers with bigger retirement incomes. This means the government could guarantee that payments wouldn't fall below the minimum Social Security benefit..

Fiscal hawks should love this plan because it would reduce the national debt significantly. Every dollar paid to a retiree from his Own America Account would be matched by a dollar of reduced Social Security payments. Over decades, tens of trillions of dollars of liabilities could be eliminated. So it's a win-win for workers and government.

Own America Accounts would make Americans wealthier—not through a government giveaway, but by simply allowing them to invest money taken from their own paychecks and collect the high returns

brought by true ownership. The accounts would build significant wealth over a lifetime for American workers, regardless of their income. They would also eliminate the multi-trillion dollar unfunded liabilities of Social Security over the next several decades.

Introduction

The retirement of the baby-boom generation has arrived. Social Security is already in permanent, long-term deficit, and the Social Security actuaries warn the program will run short of funds to pay promised benefits within the next 12 to 17 years.

Without significant reforms, paying all promised Social Security benefits will require sharp increases in payroll taxes.But most people already pay more in federal payroll taxes than in any other tax.

Even with all promised Social Security benefits paid in full, those benefits still represent a bad deal for workers, in return for the years of Social Security tax payments from workers and their employers. All families of different combinations of individuals, at all income levels, paying into Social Security today, would be able to earn far higher benefits if they were free to choose to save and invest instead in their own personal savings, investment and insurance accounts what they and their employers are required to pay into Social Security today.

What's worse, the so-called solutions to making Social Security solvent — cutting benefits or raising taxes to address the financial deficits of Social Security— would make Social Security an even worse deal for working people and their families, reducing the rate of return paid by the program even further.

With the freedom to choose personal savings, investment, and insurance accounts, instead of failing Social Security, working people would accumulate huge sums in their personal accounts, compounding year after year, over a lifetime of savings and investment. For middle-income, two-earner couples, at just standard, long-term market returns, routinely reflected in market index funds, such lifetime savings and investment would accumulate to a million dollars or more by retirement, which they would be free to choose to decide to leave wholly or in part to their families and children.

Of course, such a personal account option would be just a choice, and working people would each be free to choose to remain in Social Security as it is today, with its impending bankruptcy.

These personal accounts are also the best possible means to address inequality, as working people all across America would together be accumulating trillions in their personal accounts. These personal accounts would consequently provide working people a substantial, direct, personal ownership stake in America's business and industry.

Freeing working people to choose personal savings, investment, and insurance accounts for their Social Security benefits would eliminate all future deficits in Social Security, without cutting benefits or raising taxes, as documented by the Chief Actuary of Social Security. In the process, through personal accounts, future retirees would again enjoy much higher, not lower, benefits.

That is achieved by shifting responsibility for financing future promised benefits from the public sector to private financial markets. In the meantime, during the transition period, continuing promised Social Security benefits for those retired today would be financed by three different means:

- Freeing up general revenues through lower government spending than otherwise due to further entitlement reforms;[1]
- Temporarily continuing a portion of Social Security taxes; and
- Temporary public sector borrowing during this temporary transition for any remaining shortfall in financing remaining benefits to today's retirees, which must be financed publicly until the personal accounts are fully phased in.

Shifting payment of future Social Security benefits from taxes and redistribution in the federal budget to productive private savings and investment through the private financial markets *would involve the biggest reduction of government spending in world history!*

As the personal accounts are ultimately phased in entirely, financing all future benefits, the payroll tax can and should be ultimately abolished. *That would amount to the greatest tax cut in world history!*

Over a generation, this shift from public financing of Social Security benefits to private financing of higher retirement benefits through savings and investment would eliminate the unfunded liabilities of Social Security, which would *involve the biggest reduction in effective government debt in world history!*

Moreover, the personal accounts would serve as mighty rivers of savings and investment flowing into the economy, creating millions of new jobs and financing rising wages for young workers and their families today. They would also serve as an added inducement to enter the workforce and increase work due to the effectively higher resulting compensation because of the big boost workers would receive through the lifetime personal accounts. All of this adds up to increased economic growth and higher GDP for working people today.

Social Security is a bad deal for working people today because it operates as a pure tax-and-redistribution system, with no real savings and no real investment anywhere. The program does not save the funds workers and their employers are paying in today to finance their future benefits. Social Security uses tax payments coming in today to immediately finance benefits for today's retirees, expecting future tax payments of future workers to finance future benefits for today's workers.

Even when Social Security was running annual surpluses, almost 90 percent of the money coming in was paid out within the year to pay current beneficiaries. Even the remaining annual

[1] Peter J. Ferrara, *Power to the People: The New Road to Freedom and Prosperity for the Poor, Seniors, and Those Most In Need of the World's Best Health Care* (Chicago: The Heartland Institute, 2015).

surpluses each year were not saved and invested either, because that's not what government does. The surpluses were lent to the federal government and spent on other government programs, from foreign aid to bridges to nowhere. In return, the Social Security trust funds received internal federal IOUs promising to pay the money back when needed to pay benefits. These internal federal IOUs, now totaling roughly $2.8 trillion, are all that the so-called Social Security trust funds "own."

Social Security is a bad deal for every American worker. It's redistributive, it neither saves nor invests, and is based on a mountain of IOUs.

Working people paying into purely redistributive, pay-as-you-go Social Security, where no savings and investment at all is made, consequently they lose the compounded year-after-year market investment returns, and the increased production and economic growth such savings and investment would produce (which creates and finances those investment returns). Just moving money around, through tax and redistribution, does not create or produce anything. Instead, workers lose the compounding returns of real saving and investment, involving real capital contributing to the increased production of real goods and services.

The nonpartisan Tax Foundation conducted the calculations for this study, comparing the benefits that could be paid through personal savings, investment, and insurance accounts with the benefits promised by Social Security for different family combinations and income levels.

Retrospective calculations, involving families retiring today after a lifetime of savings and investment earning actual returns in the market over the past 45 to 50 years, include both the market boom of the 1980s and 1990s and the 2008–09 financial crisis and recession. Middle class, two-earner couples in this study reach retirement today after a lifetime of savings and investment *with a million dollars or more*. This period serves as a worst-case scenario for such a savings and investment retirement system. 1999 to 2009 — starting with the popping of the dot-com bubble and ending with the financial crisis — are the worst 10 years for the stock market in American history.

Prospective calculations, involving young workers entering the workforce today and retiring 40 to 50 years in the future, do even better. Middle class, two-earner couples reach retirement with well over a million dollars in today's dollars, in some cases $2 to 3 million, at just standard market investment returns, as represented by market index funds. This study consequently demonstrates that **today's young workers have the most to gain from personal savings and investment accounts for Social Security**.

Personal accounts are a sophisticated means of shifting from pay-as-you-go Social Security, which is just all taxation and redistribution with zero savings and investment, to a fully funded retirement system relying entirely on savings and investment and with ultimately no unfunded liabilities. That is the only real, possible solution to all of the myriad problems and deficiencies of Social Security. The transition involves just making that savings and investment.

The Retirement of the Baby Boom Generation Is Here

When we started writing about Social Security nearly 40 years ago, the long-term financial crisis of the program was in the next century. But today we are now in the next century, the baby boom's retirement has begun, and Social Security's actuaries report that the impending bankruptcy of Social Security is here.[2]

The latest Annual Report of the Social Security Board of Trustees projects that Social Security will run short of funds to pay promised benefits as soon as 12 years from now, in 2029.[3] Indeed, Social Security's disability insurance would have run out of funds to pay promised benefits last year. However, it survived only via a reallocation of funds (bailout) from the rest of Social Security, which will make the rest of the program dry up even faster.[4]

Most seniors retiring today will still be alive in 2029, when Social Security will be able to pay only 71 percent of promised benefits under so-called pessimistic assumptions,[5] with that percentage continuing to decline. And recent studies from researchers at Harvard and Dartmouth show that Social Security's actuaries routinely underestimate the program's financial problems. The so-called pessimistic projections often turn out closer to reality than "intermediate" projections.[6]

But even under intermediate projections, Social Security would run out of funds to pay promised benefits by 2034, just 17 years from now.[7] The program would then only have funds to pay 79 percent of promised benefits, and declining from there.[8]

Notably, Social Security's actuaries do not assume a single recession before its financial collapse, in 2034, or as early as 2029, even under "pessimistic" assumptions.[9] Yet, one more recession before those dates will only accelerate the date of financial collapse even sooner.

When the Social Security trust funds run out of cash to pay promised benefits in 2029 under so-called pessimistic assumptions, paying all promised benefits would require raising the 12.4 percent payroll tax rate by about 55 percent, to nearly 19 percent.[10] Paying all benefits financed by the payroll tax would ultimately require the total payroll tax rate to skyrocket to 36 percent, close to 2.5 times the current rate, under so-called pessimistic assumptions.[11]

Under so-called intermediate assumptions, the current total Social Security payroll tax rate of 12.4 percent will have to jump to nearly 17 percent by 2035 an increase of almost 40

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[2] The 2016 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds, June 22, 2016.
[3] Ibid., p. 67.
[4] Ibid.
[5] Ibid.
[6] Konstantin Kashin, Gary King, Samir Soneji, Systematic Bias and Nontransparency in U.S. Social Security Administration Finances, *Journal of Economic Perspectives*, Vol. 29, Number 2, Spring, 2015, pp. 239-258; Konstantin Kashin, Gary King, Samir Soneji, Explaining Systematic Bias and Nontransparency in U.S. Social Security Administration Finances, *Political Analysis*, American Economics Association, May 7, 2015.
[7] 2016 Annual Trustees Report, p. 66.
[8] Ibid., p. 67.
[9] Ibid., Table V.B2, pp. 114-115.
[10] Ibid., Table VI.G2, p. 209.
[11] Ibid.

percent.[12] Paying all benefits financed by the payroll tax would ultimately require the total payroll tax to nearly double.[13]

Payroll tax rate increases in these ranges will impose a burden on employers, who would try to solve the problem by laying off employees. Fewer workers means less Social Security tax revenue than expected, which will lead to higher tax rates.

This is the new "death spiral" reality for Social Security in the near future. The threat of this "death spiral," and the economic burden of such skyrocketing payroll tax rates, does threaten cuts to future promised benefits, which the U.S. Supreme Court has already specifically ruled are not constitutionally guaranteed, or even contractually guaranteed.[14]

Even with Promised Benefits, Social Security Still a Bad Deal

But let's pretend this looming Social Security financial crisis isn't happening, and instead assume that Social Security will always be able to pay currently promised benefits. Even with all promised benefits paid in full, those benefits will still represent a bad deal, in return for all of the years of Social Security tax payments from workers and their employers. Workers at all income levels, both single and dual-income families, paying into Social Security today would be able to earn far higher benefits than Social Security even promises, let alone what it can pay, if they were free to choose to save and invest instead in their own personal savings, investment and insurance accounts what they and their employers will be required to pay into Social Security during their careers.

Moreover, through their lifetime of savings and investment, working people would accumulate huge sums in their personal accounts, compounding year after year. For middle class, two-earner couples, at just standard, long-term market investment returns, such a lifetime of savings and investment would accumulate to a million dollars or more by retirement. Workers would be free to choose to decide to leave some, or all, of that huge sum to their families and children.[15] Those standard, long-term market returns would be earned by just investing in simple stock index funds, which working people can earn without any risk of choosing individual stock and bond investments, or trying to time their buys and sells.

The personal accounts would be just a choice for working people on an individual basis. Those who do not want to choose the market option would be perfectly free to choose to stay in Social Security as is, with no change. But, they would then bear the opportunity cost of foregoing the much higher returns and benefits, and the accumulation of substantial family funds offered by a lifetime of savings and investment through the personal accounts.

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[12] Ibid., ??, Table VI.G2, p. 208.
[13] Ibid.
[14] Flemming v. Nestor, 363 U.S. 603 (1960)
[15] That would be especially valuable for workers who die younger than expected, and so could leave more of their lifetime of accumulated funds to their families, unlike Social Security, where they would leave essentially nothing.

Based on the experience Chile had when it moved to personal accounts, we don't anticipate this will happen. When the people of Chile were offered that freedom of choice, more than 90 percent chose the personal accounts within a few months.

The personal accounts would consequently empower working people of all income levels, of all races and ethnic backgrounds, of all religions, of all family backgrounds and combinations, to accumulate substantial personal savings and investment over their working careers. This one change would do far more to reduce economic inequality than any other conceivable policy, including welfare. This reduction in inequality would not be achieved by seizing and redistributing existing wealth and income, which would slow economic growth and prosperity by penalizing wealth, income and productive activity. Rather, the reduction in inequality would be achieved by the creation of new wealth and income, more broadly owned among everyone throughout the entire population. That creation of new wealth and incomes would promote more, faster, and more broadly shared economic growth and prosperity for all, through productive activity, such as increased savings and investment, and jobs and work.

The Chief Actuary of Social Security scored the personal account plan introduced by U.S. Rep. Paul Ryan, now Speaker of the House, in 2004 and 2005. The Chief Actuary projected that under Ryan's bill, working people all across the country would together accumulate $7.8 trillion in their personal accounts in the first 15 years. After the first 25 years, these working people would hold $16 trillion in their accounts. That would be a dramatic blow against inequality, and greatly increase the control working people would have over the private economy. That score is still posted to this day on the website of the Social Security Administration, under the Office of the Actuary, among other scores of all ideas for closing the long-term deficit of Social Security, collected under the title of "Solvency Memoranda."

The trillions from these personal accounts would flow directly into the nation's saving and investment, which is the foundation for creating new jobs today, and financing rising wages for today's working people. That would finance millions of new jobs, adding to labor demand to drive up wages, while financing the capital equipment that increases productivity, and so generates additional funds to pay the increased wages matching the rising productivity.

The Chief Actuary also scored Ryan's plan as eliminating all future deficits of Social Security entirely, without benefit cuts or tax increases. That is achieved instead by shifting responsibility for financing so much of future promised benefits outside of the public sector altogether to private financial markets. Under the reforms envisioned for personal account choice, continuing Social Security benefits for current retirees would be financed by a portion of tax payments temporarily continuing to flow into Social Security, general revenues freed up by lower government spending than otherwise achieved through other necessary entitlement reforms to balance the budget over the long term[16], and whatever public sector borrowing is necessary during this temporary transition to finance remaining benefits to today's retirees (which must be financed publicly until the personal accounts are fully phased in). Over the first working

[16] Peter J. Ferrara, *Power to the People: The New Road to Freedom and Prosperity for the Poor, Seniors, and Those Most In Need of the World's Best Health Care* (Chicago: The Heartland Institute, 2015).

generation, the personal accounts will be phased in entirely and finance all future benefits, allowing the payroll tax ultimately to be abolished entirely.

This highlights another benefit of personal account freedom of choice for Social Security. By shifting the financing of Social Security benefits from the public sector to the private sector, future government spending drops precipitously, along with the effective tax rate. Yet, at the same time, retirees would enjoy much higher benefits from a lifetime of savings and investment, than from the tax and redistribution of Social Security, as the results of this study show below.

Indeed, personal account freedom of choice would empower all workers and their families to earn much higher benefits, often double or more what Social Security even promises, let alone what it can pay, through a lifetime of personal account savings and investment. Over a generation, this shift from public financing of Social Security benefits to private financing of higher retirement benefits through free-market savings and investment *would involve the greatest reduction of government spending in world history!*

Once the personal accounts are phased in over a generation to assume responsibility for paying future benefits, the payroll tax, which is the highest tax most working people pay, can and should be eliminated altogether. *That would amount to the greatest tax cut in world history!*

The personal accounts are actually a means of fundamentally transforming Social Security from a tax-and-redistribution, pay-as-you-go system to a fully funded, savings and investment system. That has not been well understood. In the process, the unfunded liabilities of Social Security would disappear. That should be recognized as the only real solution for Social Security, rather than just trying to jigger around taxes and benefits to balance the Social Security budget, which is not the goal here. That would do nothing to pay higher and better benefits for working people. Rather, that would only make Social Security an even worse deal for working people by reducing further the effective rate of return paid by the program. Eliminating the unfunded liabilities of Social Security would involve *the greatest reduction in government debt in world history!*

Why Social Security Is a Bad Deal for Working People Today

Why are the benefits of personal accounts as discussed below so much higher than what Social Security can even promise let alone what it can pay?

Social Security operates as a pure tax-and-redistribution system, with no real savings and investment anywhere. The program does not save the funds workers and their employers are paying in today to finance their future benefits. Social Security uses the tax payments coming in today to immediately finance the benefits for today's retirees. Social Security expects the future tax payments of future workers to finance the future benefits for today's workers. It robs Peter to pay grandma.

When Social Security was running annual surpluses, almost 90 percent of the money coming in was paid out within the year to beneficiaries. Unfortunately, those annual surpluses were not saved and invested, because that's not what government does. The federal government borrowed the money for other government programs, from foreign aid to bridges to nowhere. In return, the Social Security trust funds received federal IOUs. These IOUs are all that is held by the so-called Social Security trust funds, now totaling roughly $2.8 trillion.

As a result, Social Security is not a savings and investment system. It is a tax and redistribution system, where money is taken from one group of people through taxes and just immediately redistributed to other people in benefits and other government spending. In the process, nothing is created, nothing is produced, as occurs with real savings and investment.

Real savings and investment is capital, which creates and expands businesses, and jobs, and pays for equipping workers with the latest tools and equipment that makes them more productive. In the process, real economic growth is created. More goods and services are produced. Gross domestic product is increased. That economic growth, increased production of real goods and services, and increased gross domestic product finances the return to capital investment paid to the investors. That return to capital cumulates and compounds, year after year, growing to huge amounts over a lifetime of savings and investment.

When Albert Einstein was asked, what is the most powerful force in the universe, the inventor of the atomic bomb and father of nuclear energy, replied, "compound interest." With personal accounts for Social Security, that most powerful force in the universe is what working people have working for them, over their entire lifetimes.

As we will show below, at just standard, long-term market investment returns middle class, two-earner couples, saving and investing in their own personal savings, investment and insurance accounts what they and their employers are otherwise required to pay into Social Security over their careers, would retire with a million dollars or more in their accounts, in today's constant, inflation-adjusted dollars. Those standard, long-term market investment returns are readily available to them through readily available, market index funds.

Moreover, the full social gain in switching from a purely redistributive, pay-as-you-go system like Social Security to a fully funded, real savings-and-investment system like personal accounts is measured not by the rate of return on stock investments, or by the market returns on various bonds, but by the before-tax real rate of return to capital. Harvard Professor Martin Feldstein explained this all the way back in the 1970s. The before-tax real rate of return to capital measures the full value of the increased production resulting from increased savings and investment. That is actually higher than long-term stock returns because those stock returns are partially after-tax returns left after the multiple taxation of capital at the corporate and business level. Feldstein estimates that real, before-tax return to capital as 9.5 percent.[17] The increased tax revenue produced by increased savings and investment is part of the full social gain resulting from that increased savings and investment.

This is what is lost by forcing working people to pay into purely redistributive, pay-as-you-go Social Security, where no savings and investment at all is made, no economic growth or increased production is produced, and no market investment returns are created or earned. Just moving money around, through tax and redistribution, does not create or produce anything, so

[17] Feldstein, "The Missing Piece in Policy Analysis."

workers lose the compounding real returns of real saving and investment, involving real capital contributing to the increased production of real goods and services. They lose Einstein's most powerful force in the universe.

By sharp contrast, the internal federal IOUs held in the Social Security trust funds are rightly accounted for in federal finances not as assets but as part of the Gross Federal Debt, subject to the national debt limit. They do not represent savings and investment, but actually additional liabilities of federal taxpayers. As a technical, legal matter, those IOUs are nothing more than a statement of the legal authority that Social Security has to draw from general revenues, in addition to payroll taxes. The real problem is not that the government cannot be counted on to pay those IOUs back. The real problem is that it's going to be hell—for you—to pay them back.

When Social Security runs a deficit, as it is doing today and will do indefinitely into the future until the trust funds are exhausted, Social Security turns some of those trust fund IOUs over to the U.S. Treasury to get money back to continue paying promised benefits. But there is no cash or other savings and investment held in reserve to pay back those IOUs. So where does the U.S. Treasury plan to get the money to pay them back? From you.

Since those IOUs are national debt, not assets of the federal government, you and other taxpayers owe them. You will have to pay them back for retirees to continue to receive all their promised Social Security benefits. Paying back the IOUs will be in addition to the hundreds of billions of dollars you and other taxpayers must continue to pay in payroll taxes every year into Social Security. When Social Security comes to the Treasury with trust fund IOUs to get the cash to pay promised benefits, the Treasury will get that cash either by raising your taxes or by borrowing still more and running even bigger deficits. This is why the long-term Social Security financing crisis has already begun in fact.

This financing pattern will continue until the Social Security trust funds run out of IOUs and are exhausted. From 2010, when the deficits started, until trust fund exhaustion sometime ***between 2028 and 2034, the American people will have to come up with roughly $7.3 trillion to cover all the IOUs that will have accumulated in the Social Security trust funds through those years.***[18] That is in addition to continuing payroll taxes. Consequently, it is under current Social Security financing that the current working generation will have to essentially pay twice for their retirement.

As in any Ponzi scheme, a tax-and-redistribution system can pay any real return at all only to the extent that tax revenues grow over time. Payroll tax revenues grow over time by the rate of growth of per capita real wages, which Social Security Administration data show to be around 1 percent per year, plus the rate of growth of the working population. With U.S. fertility rates barely keeping up with the replacement rate of 2.1 lifetime births per woman necessary to maintain a stable population, the working population is only growing to the extent of net immigration (which is facing political challenge these days, as well as economic challenges due

[18] Calculated from 2012 Annual Report of Trustees of the Old Age and Survivors Insurance and Disability Insurance Trust Funds, Table VI.F8. This total includes additional interest that will continue to accrue on the trust fund bonds.

to long-term economic stagnation). This indicates that Social Security's tax-and-redistribution, pay-as-you-go system can only pay any return at all of about 1 percent.

To calculate the real returns promised by Social Security, start by taking the actuarial value of the program's promised benefits: retirement benefits, survivors benefits, and disability benefits. Then compare that to the actuarial value of the program's taxes. An earlier study[19] examined a hypothetical family where the husband works and earns the average income for full-time male workers each year and the wife works and earns the average income for full-time female workers each year. They have two children and they each started working in 1985 at age 22, right after they graduate from college.

Even if all of their promised Social Security benefits were somehow paid, those benefits would represent an annual real rate of return of less than 1 percent (0.78 percent) on the taxes paid by these two workers and their employers over their working careers. Almost all hypothetical two-earner couples examined in the study would receive a real return right around this 0.78 percent return. Single workers end up with an even worse deal. A full-time, average-income single worker would receive a real return through the system of around 0 percent (0.31 percent). Overall, for most young workers today, even if the program could somehow pay all of its promised benefits, Social Security would pay a real return of around 1.5 percent or less.

Moreover, note that these Social Security returns do not represent actual investment returns resulting from, and financed by, increased production and economic growth. They represent and result from increased and growing *redistribution* over time, as in a Ponzi scheme in its growth phase. Those *redistribution* returns can never remotely hope to approach and keep up with the *produced* returns created and earned by real savings and investment.

Many above-average-income workers would actually receive a negative real return from Social Security, again even assuming all promised benefits are somehow paid. A negative real return is like depositing your money in the bank, and instead of the bank paying you interest, you pay the bank interest on your deposit. This is Social Security for a lot of people today.

There are workers who along with their employers today are paying more than $10,000 a year, each and every year, into Social Security. But they are effectively losing money on it every year with a negative real rate of return from the system, when they could be earning real interest on that money. This is counting the value of all promised benefits from the program on an actuarial basis, survivors and disability benefits as well as retirement benefits.

Worst of all, **this is where Social Security is headed for all workers in the future.** If the government raises taxes and/or cuts benefits, or does both, to eliminate the long-term deficits of Social Security, then the effective rate of return under Social Security will decline further for everyone. Eventually, virtually all workers under Social Security would be driven down into the range of negative effective real returns.

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[19] Peter J. Ferrara and Michael Tanner, *A New Deal for Social Security*, (Washington, DC: Cato Institute, 1998), Chapter 4.

Compare that to the standard long-term market returns workers would earn in a fully funded savings and investment system, where each worker's tax payments are saved and invested to finance his or her future benefits. Jeremy Siegel, in his definitive book *Stocks for the Long Run,* documents that the real annual compound rate of return on corporate stocks in the United States over the 200-year period 1802 to 2001 was 6.9 percent, after inflation.[20] It was the same 6.9 percent over the period 1926 to 2001, which included the Great Depression, World War II, the Korean War, the Vietnam War, and the Great Inflation of the 1970s.[21]

From 1926 to 2013, the real rate of return on Large Cap stocks, representing the larger companies in America, was 8.9 percent. The real rate of return on Small Cap stocks, representing smaller, mid-size firms, was 13.5 percent. A sophisticated, diversified portfolio of 90 percent Large Cap and 10 percent Small Cap stocks earned a 9.36 percent real return over that period. *This period includes the 2008 financial crisis.*

Moreover, over the entire postwar era (since 1946), corporate bonds have averaged a real return of 4 percent.[22] Feldstein, who is also Chairman of the National Bureau of Economic Research, and his associate Andrew Samwick, calculated in 1997 a portfolio of 60 percent stocks and 40 percent bonds would have generated a real return of 5.5 percent since 1946. They calculated the same return over the period going back to 1926.[23]

Compounding these much higher returns over a lifetime adds up to an enormous difference compared to the much lower returns offered by Social Security's pay-as-you-go, tax-and-redistribution system.

Study Results

The nonpartisan Tax Foundation conducted the calculations for this study comparing the benefits that could be paid through personal savings, investment, and insurance accounts with the benefits promised by Social Security. The results were calculated for different hypothetical family combinations, with varying family composition (single or married, with or without children, one-earner or two- couples), work histories (low wage starting work after high school, middle class starting after work after college, higher wage starting work after graduate or professional school), earnings histories (25 percent, 45 percent, 100 percent, 160 percent, 300 percent of median income, with differing combinations among two-earner couples), investment strategies (60 percent stocks and 40 percent bonds, 100 percent stock index funds).

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[20] Jeremy Siegel, *Stocks for the Long Run* (New York: McGraw-Hill, 2002), 3rd ed.

[21] Ibid.; *Stocks, Bonds, Bills, and Inflation 2014 Yearbook* (Chicago: Ibbotson Associates); Jeremy Siegel, *Stocks for the Long Run* (Chicago: Irwin Professional Publishing, 2014).

[22] Edgar K. Browning, "The Anatomy of Social Security and Medicare," *The Independent Review,* Vol. XIII, no. 1, Summer 2008, p. 12. See also, Siegel (the average real return on corporate bonds over the 200 year period from 1802 to 2001 was 5 percent); José Piñera, "Toward a World of Worker Capitalists," Transform the Americas, www.transformamericas.com, April 2000.

[23] Martin Feldstein and Andrew Samwick, "The Economics of Prefunding Social Security and Medicare Benefits," National Bureau of Economic Research Working Paper no. 6055, National Bureau of Economic Research, Cambridge, MA, June, 1997.

Some of the calculations were done assuming 10 percent of taxable wages were contributed to the personal account each year. Others were done with a more progressive twist, assuming that 10 percent of wages up to $20,000 per year were contributed to the accounts, and 6.5 percent after that, up to the maximum taxable income. Since Social Security benefits are skewed to favor lower-income workers, that progressive twist tends to equalize the percentage net gains from the personal accounts among families.

Some calculations were retrospective, examining families retiring at retirement age today, who invested earning the actual investment returns of the past 45 to 50 years. Others were prospective, entering the workforce today to retire 45 to 50 years into the future, earning average future returns based on past experience. Earnings histories were all scaled to reflect more typical experience, with workers earning the least just out of school, incomes rising with experience over the years, peaking in the 50s, and then scaling back some as retirement approaches and work slows down.

Table 1: Workers who retired in 2015

	Income 1: % of median income earned	Income 2: % of median income earned	Account value at retirement	Annual personal acct annuity	Annual return on investment	Annual Social Security promised
Couple A	45*	25*	$738,360	$58,807	$40,610	$21,035
Couple B	100	25*	$1,266,559	$100,876	$69,660	$29,470
Couple C	100	45	$1,477,006	$117,638	$81,235	$31,570
Couple D	100	100	$2,005,205	$159,707	$110,286	$39,293
Couple E	160	100	$2,606,662	$207,610	$143,366	$37,961
Couple F	160	160	$3,208,119	$255,514	$176,447	$52,075
Couple G	25	N/A	$263,957	$21,023	$14,518	$13,667
Couple H	45	N/A	$474,403	$37,784	$26,092	$17,885
Couple I	100	N/A	$1,002,603	$79,853	$55,143	$29,470
Couple J	300	N/A	$2,100,654	$167,309	$115,536	$47,509
Single A	25	N/A	$263,957	$21,023	$14,517	$9,112
Single B	45	N/A	$474,403	$37,784	$26,092	$11,923
Single C	100	N/A	$1,002,603	$79,853	$55,143	$19,646
Single D	300	N/A	$2,100,654	$167,309	$115,536	$47,509

Assumptions:
All workers entered workforce in 1971 except as denoted by *. Workers with * entered workforce in 1967.
10% of Social Security taxable income
isinvested
For annual ROI: Actual returns earned in the marketplace each year; Annual return

with 60% stocks/40% bonds (5.5% real return)

Let's look at a sample of the retrospective calculations shown in Table 1 above. In nearly every case, the workers, whether they are dual-earner, single-earners, or single workers, began working in 1971 and retired in 2015. In each case, 10 percent of Social Security taxable wages is invested in the accounts, in stock index funds, earning the actual returns earned in that year for stocks. To calculate the benefits payable through the annual return on investment, the personal account continued to be invested in retirement 60 percent in a stock index fund, and 40 percent in a bond index fund, earning a 5.5 percent real annual return.

In every instance, whether the retirees chose the annual annuity or the annual return on investment, they received more than the Social Security benefits they were promised, generally two to three times as much, and more. For workers who chose the Annual Return on Investment benefits, they were able to leave the personal account funds to their family and children, or other designated heir. For every family with at least one worker earning 100 percent of the median income over their career on average, the personal account funds were worth more than a million dollars, in some cases two to three million and more.

It's a pretty stark picture in some cases. Clearly, those workers who earn less have less in their retirement account. However, their annual annuity or annual return on investment still far exceed what Social Security promises. For example, consider the middle class, two-earner couple with each earning over their career 100 percent of the median income on average. They reach retirement with $2 million in their account, which would finance an annuity paying four times what Social Security even promises, let alone what it can pay. Or, the couple could continue to invest the account in retirement 60 percent in stocks and 40 percent in bonds, living off continued investment returns nearly 3 times (2.8) what Social Security promises the couple, which would leave the $2 million fund intact for the family and children at death.

Or, consider the couple earning 45 and 25 percent of the median income, respectively, (a career low income couple) reaching retirement with a personal account of $738,360. That fund would either pay them an annual annuity of $58,807, nearly three times (2.8) the $21,035 Social Security promises them. Or, continuing to invest the personal account directly 60 percent in stocks and 40 percent in bonds throughout retirement would yield investment returns of $40,610 each year, nearly twice what Social Security even promises them, while leaving the nearly $750,000 dollars intact for their children or other heirs.

Table 2: Workers entering workforce in 2015

	Income 1: % of median income earned	**Income 2: % of median income earned**	**Account value at retirement**	**Annual personal acct annuity**	**Annual return on investment**	**Annual Social Security promised**
Couple A	45	25	$1,020,136	$77,711	$56,107	$36,998
Couple B	100	25	$1,710,542	$130,305	$94,080	$51,880
Couple C	100	45	$2,000,944	$152,425	$110,052	$55,560
Couple D	100	100	$2,691,351	$205,018	$148,024	$69,173

Couple E	45	N/A	$544,269	$49,916	$36,040	$31,460
Couple F	100	N/A	$1,345,675	$102,509	$74,012	$51,880
Couple G	300	N/A	$3,061,876	$233,243	$168,403	$84,149
Single A	45	N/A	$655,269	$49,916	$36,040	$20,973
Single B	100	N/A	$1,345,675	$102,509	$74,012	$34,587
Single C	300	N/A	$3,061,876	$233,243	$168,403	$56,111

Note: Amounts in today's 2015 dollars, adjusted for inflation

Assumptions:
All workers retire in 2060
10% of all income is invested
For annual ROI: Annual return with 60% stocks/40% bonds (5.5% real return)

Now let's look at workers who entered the workforce in 2015, as shown in Table 2 above. The study assumes 10 percent of Social Security taxable wage income is invested in a stock index fund earning the same historical returns on average — with all workers retiring in 2060. The results are all calculated in today's 2015 dollars, adjusted for inflation. A couple earning 25 and 45 percent of the median income, respectively, does even better than the couple with similar incomes retiring in 2015. The couple just starting out in 2015 will, at retirement, have $1,020,136 in their personal account.

The account would finance an annual annuity of $77,711, double the $36,998 Social Security promises them, but cannot pay. Or, the couple could choose to continue investing the personal account funds directly during retirement years, 60 percent in stocks and 40 percent in bonds, generating an annual investment payout of $56,107. That's 152 percent of what Social Security promises but cannot pay, while allowing this couple to leave the million dollars to their family and children or other heirs.

These are just two examples from our two charts, but the results from the study are clear: Whether you started working in the early 1970s or 2015, personal accounts are a better deal for retirees and their heirs.

These calculations reveal two critical truths:

First, the retrospective calculations, involving families retiring today after a lifetime of savings investment earning the actual returns in the market over the past 45 to 50 years, include both the market boom of the 1980s and 1990s and the 2008–09 financial crisis and recession. Yes, there were investment losses and poor returns during the latter time. But, while the economy has yet to fully recover, the investment markets have. That is why our hypothetical families in this study who reach retirement today still retire with sizable nest eggs(middle-class families retire as millionaires, or even multimillionaires). The simplistic rhetoric and simpleminded claims that such a retirement savings-and-investment system would have been destroyed by the financial crisis are false and misleading.

In fact, that period including the financial crisis serves as a worst-case scenario for such a savings-and-investment retirement system. The years 1999 to 2009, starting with the popping of the dot-com bubble, and ending with the financial crisis, are the worst 10 years for the stock market in American history. The lesson to draw is not that savings and investment are not a sound basis for a retirement system, as former President Obama and others seem to want to claim. The eternal truth still is that *only* fully funded systems based on lifetimes of savings and investment can serve as a sound basis for a retirement system. This truth is also demonstrated by other personal account savings-and-investment retirement systems around the world, which all suffered downturns during the financial crisis, but rebounded to new heights of prosperity afterward.

Second, the prospective calculations, involving young workers entering the workforce today and retiring 40 to 50 years in the future after a lifetime of savings and investment, demonstrate that *today's young workers have the most to gain from personal savings and investment accounts for Social Security*. **All of these workers and their families, of all income levels and all family combinations, would receive much higher benefits than Social Security even promises, let alone what it can pay**. **Indeed, through personal accounts, even more of these workers and their families would retire as millionaires in the future**.

Moreover, the personal accounts serve as mighty rivers of savings and investment flowing into the economy today, creating millions of new jobs and financing rising wages for young workers and their families today. Through these accounts, working people all over America will each gain a substantial, direct, personal, ownership stake in America's business and industry. This will directly address the inequality issue, with trillions accumulating in the personal accounts of working people.

Survivors and Disability Benefits

When workers die before retirement, they would leave behind a lifetime of savings and investment in their personal accounts that would self-fund far more than the survivors benefits promised by Social Security. This would be true even at younger ages, as the savings and investment in the personal accounts after just 10 to 15 years of work would grow sufficiently to self-fund promised Social Security survivors benefits and more. That is especially true since Social Security only pays survivors benefits before retirement if the worker leaves behind children who are younger than 18, or attending college. No survivors benefits are paid for childless couples before retirement, or at all, in the case of single workers.

For modest amounts for a few years, a worker could purchase term-life insurance to supplement what is accumulated in his or her personal account until the account itself can pay at least the survivors benefits that Social Security promises. That supplemental life insurance would decline as the personal account funds grow. The account option could be designed to finance those small amounts for a few years until the account grows large enough to self-fund all survivors benefits itself. This is how the system has worked successfully in Chile for nearly 40 years.

Lawmakers can draft the legislation so that workers with personal accounts could continue to receive disability benefits from Social Security. Those benefits can include making retirement contributions to the personal accounts for the years the worker was not working because of the disability. The personal account funds would then continue to be available to finance retirement benefits for the worker whether he continues to be disabled, or recovers. Workers would no longer be required to pay Social Security taxes while not working because of disability.

The personal account option can also be expanded to cover more of what workers and their employers are paying in payroll taxes to provide additional funds to purchase private disability insurance to go along with the account package. This is also how the system has worked in Chile for nearly 40 years now.

A Proposal for Reform

It's clear that personal accounts are a win for America's workers. The question is, does Congress have the willpower to make it happen? Or, can voters be moved to give Congress and a President the willpower to make it happen?

We propose empowering all working people 40 and under with the freedom to choose personal savings, investment, and insurance accounts to finance their retirement. Those who make that choice could direct 10 of their 12.4 percentage points of their current Social Security payroll taxes to their personal account. They could make investment choices for those accounts ranging from 100 percent stock index funds to 50 percent stock index funds and 50 percent bond index funds. Some account funds would be used to purchase life insurance each year sufficient to pay survivors benefits, along with the investment funds left behind at death, at least equal to what Social Security promises to pay the worker.

Workers could also choose Social Security for their future benefits as promised to them today. There would be no cuts in Social Security benefits, or delays in the retirement age, or tax increases for those who make this choice. That is feasible because the Chief Actuary of Social Security concluded when scoring Rep. Paul Ryan's personal account proposal in 2004 and 2005 that such personal accounts are so obviously such a better deal than Social Security that he assumed 100 percent of all workers would choose the personal accounts. So if a few dissenters don't choose the personal accounts, that would not make a significant difference.

When they retire, workers could choose to use some or all of the accumulated funds to either finance annuity benefits for the rest of their lives, or live off of the investment returns from continued investment of the personal account funds. By living off the investment returns, they would have the added choice of leaving the personal account funds to their families and children or other heirs.

Workers who chose personal accounts for the entirety of their careers would receive the benefits payable through the accounts for their retirement and survivors benefits entirely. Workers who were already in the workforce when the personal account option became legal would also receive the proportion of Social Security retirement and survivors benefits that they had already paid through past payroll taxes. All disability benefits would continue to be paid through Social Security for now, with the possibility of the option being expanded in the future to provide for disability benefits to be paid through private disability insurance.

The federal government would guarantee that all workers who chose the personal account option would receive at least the same benefits as Social Security promises them today. As we have discussed, the results of this study highlight that it is extremely unlikely that the benefits payable through a lifetime of savings and investment would be less than what Social Security currently promises, so this guarantee is unlikely to ever be needed. A similar guarantee in the Chilean personal accounts system we mentioned earlier reportedly has not been required to pay any benefits since that personal accounts system was first adopted in 1981.

Nevertheless, to assure financing for that guarantee in a U.S. personal accounts plan, the personal accounts legislation can provide for a tax of 0.25 percent on the portion of personal account funds over $1 million. That tax would be suspended when enough funds accumulate to pay one year of benefits.

Outside the tax mentioned above, personal accounts would be free of any federal, state and local taxes interfering with the reform and achievement of its goals. No taxes on the buildup of the accounts. No taxes on legally permissible withdrawals after retirement. And no taxes at death.

Elimination of Unfunded Liabilities. This reform would ultimately eliminate all deficits and unfunded liabilities of Social Security by shifting responsibility from taxpayers to savings and investment in private financial markets. Yet, as the results of this study show, those choosing personal accounts would likely receive much higher benefits from a lifetime of savings and investment than through Social Security.

In shifting the financing of Social Security benefits from taxpayers and the public sector to savings and investment and the private financial markets, this solution would produce dramatic future reductions in government spending. In fact, the move to personal accounts would result in *the greatest reduction in government spending in world history.*

The reform would begin with a significant reduction in effective taxes as well, as workers who choose the personal accounts would pay only 10 percent of taxable wages into the accounts for those benefits. Those payments can be split between employer and employee, mirroring the current payroll tax. But, over time, as the reform is fully phased in, Social Security payroll taxes would no longer be needed to finance government spending, and can and should be phased out entirely. That would amount to *the greatest tax cut in world history.*

Higher Savings, Investment and Growth. The personal accounts would produce a sharp increase in savings and investment for the economy, which would be dramatically pro-growth. The mighty rivers of such saving and investment flowing through the accounts would create new and expanded businesses, involving millions of new jobs for workers, resulting in increased demand for labor increasing wages across the entire labor market. The savings and investment would also equip these workers today with new tools that would increase their productivity, providing the funds to finance their wage increases. This would involve substantial increases in economic growth and prosperity, as would the payroll tax reductions ultimately resulting from the reforms as well.

The reform would also produce trillions of dollars held by working people all over the country in their own personal accounts. That Chief Actuary of Social Security determined the reform would add $7.8 trillion to the retirement accounts of American workers after just 15 years and $16 trillion after the first 25 years. That would do far more to reduce wealth inequality than any other reform ever advanced. We would achieve this reduction in inequality not by seizing and redistributing existing wealth of others today, but through the creation of new wealth and income more equally owned. In the process, we would create widespread prosperity.

Increased Compensation, Employment, and Growth. The enormous accumulation of funds in the personal accounts, and the much higher retirement benefits the personal accounts would pay, would amount to increased compensation for workers. That would sharply increase labor force participation because compensation for work would effectively be much higher. The net result of the increase in employment and wages would be higher economic growth and increased GDP.

The Transition

A transition financing issue arises because Social Security is a tax-and-redistribution, pay-as-you-go system, with no savings and investment to back up benefit promises at all. The Social Security trust funds are another claim on tax revenues (general revenues, mostly income taxes), in addition to payroll taxes, not actual savings and investment. If workers are going to be free to choose to save and invest their payroll taxes in personal savings and investment accounts, new money must come from somewhere else to continue to pay all benefits to today's retirees, while the government's obligations to the next generation of retirees are phased out through the personal accounts.

The personal account reform involves shifting Social Security from a tax-and-redistribution system to a fully funded savings and investment system, eliminating all future unfunded liabilities, as discussed above. That is the only long-term solution for Social Security. The transition financing needed for such reform would require financing the savings and investment involved in shifting to such a fully funded system. That savings and investment would just be a transitional cash-flow issue, not a transition "cost." That is because saving and investment is not actually a cost of the reform, but another benefit from it, involving a huge advantage for working people across America.

In other words, if you save $2,000 this month, you would not say that cost you $2,000. It didn't cost you anything at all, because you still have it in your savings. Of course, because you can't have your cake and eat it too, you can't spend the $2,000 in addition to saving it, because then you wouldn't be saving it. But that is true of any savings increase. It is exactly the same as with any underfunded pension plan, where the sponsor has to finance increasing the funding up to 100 percent.

Ideally, the necessary transition financing would occur through reduced government spending resulting from other needed entitlement reforms, which would also increase economic growth and prosperity for everyone. The funds freed up by such reduced government spending can then be devoted to financing the transition to personal accounts (which means financing continued Social Security benefits during that transition). Those further reforms of welfare and health care programs also involve positive, populist, pro-growth reforms that would better serve the poor and the sick dependent on the programs.[24] With taxpayers currently spending a trillion dollars a year on welfare, and more than $2 trillion a year on Obamacare, Medicare and Medicaid, more than enough can be saved on necessary reforms of those programs, making them more efficient and effective, to finance the transition to personal accounts.[25]

Alternatively, the transition can be financed, at least in part, through borrowing some of the increased savings produced through the personal accounts themselves. That can help finance the transition, while still allowing for a huge, pro-growth increase in savings and investment on net. Other means of financing the transition include auctioning off excess federal lands mostly held in the Western states, where the federal government still owns huge proportions of the land in the states. As much as another trillion could come from maximizing leases and royalties for production of oil, gas, and other forms of energy on federal lands and waters.

Conclusion: The Only Real Solution for Social Security

Fully funding Social Security through personal savings, investment, and insurance accounts is the only real solution to all the problems of the program. Through such personal accounts, the long-term financing crisis of the program can be eliminated entirely with no tax increases or benefit cuts, as the score of the 2004–2005 Ryan-Sununu bill by the Chief Actuary of Social Security showed.

Moreover, through such personal accounts, retirees of all prior income levels and family combinations would receive much higher benefits, and substantial lifetime accumulations of wealth, as the Tax Foundation calculations showed, as well as the score of the Chief Actuary of Social Security. Personal accounts would do far more to reduce economic inequality than anything else ever proposed, including the introduction and subsequent reform of welfare.

And through such personal accounts, the unfunded liabilities of Social Security and, eventually, Medicare would also be eliminated. The only way such unfunded liabilities can be addressed, and eventually eliminated, is to fully fund both programs over a generation or two. And the only way to fully fund these huge programs is through decentralized personal savings and investment accounts, held by millions of workers and their families all over America, rather than one or two huge, centralized, government investment funds, where the government would end up owning virtually the entire, formerly private economy.

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[24] Ferrara, *Power to the People, supra*.
[25] Those reforms are discussed and explained in detail in Ferrara, *Power to the People, supra*.

There is no alternative to solving the enormous, $210 trillion "fiscal gap"[26] other than by undertaking to fully fund these programs. We cannot, and should not, even try to address that gap through $210 trillion in tax increases and benefit cuts.[27] That would just involve an alternative way to collapse our economy, and, indeed, our entire democratic system.

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[26] Larry Kotlikoff

[27] One highly touted means of cutting promised Social Security benefits is through changing the fundamental Social Security benefit formula through what is called "price-indexing." Addressing the long-term Social Security financing gap, where if nothing is done, by the time today's young workers retire Social Security would only have enough funds to pay 70 percent or so of promised benefits, this reform "solves" that problem by changing the basic benefit formula so that by the time today's young workers retire, they will only be entitled to 70 percent or so of currently promised benefits. Thus, the Social Security budget would be balanced. But merely balancing the Social Security budget, while driving everyone on Social Security down into negative real returns, is not the goal. That is not going to come anywhere near eliminating Social Security's unfunded liabilities, or solving all of the program's problems, particularly in a positive, populist, pro-growth fashion as discussed above.