ROADMAP FOR THE 21ST CENTURY
NATIONAL TAX-LIMITATION COMMITTEE

Personal Accounts for Social Security and Medicare

Prepared by the Working Group on Social Security and Medicare
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Editor's note: Substantial portions of the following analysis are reprinted from 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.[1]

Introduction

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 11 years from now, in 2028.[2] Social Security's disability insurance is running out of funds to pay promised benefits *this year*, assumed to survive only by a reallocation of funds from the rest of Social Security, which will make the rest of the program run out of funds sooner.[3]

Most seniors retiring today will still be alive in 2028, when Social Security will be able to pay only 71 percent of promised benefits, an amount that falls over time, under so-called pessimistic assumptions.[4] Researchers at Harvard and Dartmouth universities showed in studies last year that Social Security's actuaries routinely underestimate the program's financial problems. So-called "pessimistic" projections often turn out closer to reality than "intermediate" projections.[5]

Even under intermediate projections, Social Security would run out of funds to pay promised benefits by 2034, just 17 years from now.[6] The program then would have enough funds to pay only 79 percent of promised benefits, an amount that declines over time.[7]

Notably, Social Security's actuaries do not assume a single recession before the program's financial collapse in 2034, or as early as 2028, even under "pessimistic" assumptions. One more recession over the next 11 to 17 years will

[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* (Arlington Heights, IL: The Heartland Institute, 2015).

[2] 2016 Annual Report of the Board of Trustees of the Old Age and Survivors Insurance and Disability Insurance Trust Funds, p. 65, https://www.ssa.gov/oact/tr/2016/tr2016.pdf.

[3] *Ibid.*, pp. 2, 4–5.

[4] *Ibid.*, p. 65.

[5] Konstantin Kashin, Gary King, and Samir Soneji, "Systematic Bias and Nontransparency in U.S. Social Security Administration Finances," *Journal of Economic Perspectives* **29** (Spring 2015): 239–58; Konstantin Kashin, Gary King, and Samir Soneji, "Explaining Systematic Bias and Nontransparency in U.S. Social Security Administration Finances," *Political Analysis*, American Economics Association, May 7, 2015.

[6] 2016 Annual Report, *supra* note.

[7] *Ibid.*

accelerate the date of the program's financial collapse.

When the Social Security trust funds run out of cash to pay promised benefits, paying all promised benefits would require immediately raising the 12.4 percent payroll tax rate by about 55 percent, to nearly 19 percent.[8] Paying all benefits financed by the payroll tax would ultimately require the total payroll tax rate to skyrocket to 36 percent, nearly 2½ times the current rate, under so-called pessimistic assumptions.[9]

Under so-called intermediate assumptions, the current total Social Security payroll tax rate of 12.4 percent will have to jump in 2034 by close to 40 percent, to nearly 17 percent.[10] Paying all benefits financed by the payroll tax would ultimately require a 50 percent payroll tax increase.[11]

Payroll tax rate increases in these ranges will cause rising unemployment, which in turn will mean less revenue than expected, which will require still 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, threatens cuts to future promised benefits, which the U.S. Supreme Court has already specifically ruled are not constitutionally or even contractually guaranteed.[12]

Social Security Is a Bad Deal

For now, let's dismiss this looming crisis and assume – as most politicians and bureaucrats do – that Social Security will always be able to pay currently promised benefits. Even with all promised benefits paid in full, those benefits still represent a bad deal in return for all of the years of Social Security tax payments from workers and their employers.

All individuals and families, at all income levels, paying into Social Security today would be able to earn far higher benefits than Social Security even promises, let alone what it can pay in the future, 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 over their working careers.

Over that lifetime of savings and investment, working people would be accumulating huge sums in their personal accounts, compounding year after year. For average-income, two-earner couples – assuming only standard, long-term market investment returns – such lifetime savings and investment would accumulate to close to a million dollars or more by retirement, a huge sum they would be free to leave at least in part to their families and children. That would be especially valuable for workers who die younger than expected and could leave their lifetime of accumulated funds to their families. Under Social Security, those workers can leave their families essentially nothing. Those standard, long-term market returns would be earned by investing in simple stock index funds, in which working people can invest without any risk of choosing individual stock and bond investments or trying to "time" their buys and sells.

The personal accounts would empower working people of all income levels – of all races and ethnic backgrounds, of all religions, of all family backgrounds and combinations – with the power to accumulate substantial personal savings and investment over their working careers, doing far more to reduce economic inequality than any other policy.

That reduction in inequality would not be achieved by seizing and redistributing existing wealth, which would retard economic growth by penalizing wealth, incomes, and productive activity. Rather, the reduction in inequality would be achieved by the creation of new wealth, more broadly owned among everyone, throughout the entire population. That creation of new wealth

[8] *Ibid.*, Table VI.G2, p. 208.

[9] *Ibid.*

[10] *Ibid.*

[11] *Ibid.*

[12] *Flemming* v. *Nestor*, 363 U.S. 603 (1960).

would promote more, faster, and more broadly shared prosperity for all.

Congressman Paul Ryan (R-WI) introduced a plan for personal accounts that was scored by the Chief Actuary of Social Security in 2004 and 2005. The Chief Actuary projected that under Ryan's bill, after 15 years working people across the country would together accumulate $7.8 trillion in their personal accounts. After 25 years, those working people would hold $16 trillion in their accounts. That would be a dramatic blow against wealth inequality in the United States and would greatly increase the control working people have over the private economy. The Chief Actuary's score for Ryan's proposal is posted on the website of the Social Security Administration, under the Office of the Actuary, among scores for other ideas for closing the long-term deficit of Social Security, collected under the title of "Solvency Memoranda."

All those trillions of dollars going into personal accounts over the years would add to the nation's saving and investment, which is the foundation for creating new jobs and financing rising wages. Millions of new jobs would be created, adding to labor demand to drive up wages, financing the capital equipment that increases productivity, and thus generating 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. How is that possible? By shifting most responsibility for financing future promised benefits away from the public sector and to private financial markets.

Under the personal accounts proposal, Social Security benefits for current retirees would continue to be financed by a portion of tax payments continuing to flow into Social Security.[13] Whatever public-sector borrowing might be necessary during this transition to finance remaining benefits to today's retirees must be financed publicly until the personal accounts are fully phased in. Over the first working generation, the personal accounts will be phased in entirely and will finance all future benefits, allowing the payroll tax ultimately to be abolished entirely.

This highlights another benefit of personal accounts for Social Security. By shifting the financing of Social Security benefits from the public sector to the private sector, the personal accounts result in a dramatic reduction in future government spending, and in taxes as well. Yet at the same time, retirees would enjoy much higher benefits from a lifetime of savings and investment than they would ever see from the tax and redistribution of Social Security, as the calculations below will show.

The freedom to invest in personal accounts would empower all workers and their families to earn much higher benefits – in many cases double or more what Social Security even promises, let alone what it can pay. Over a generation, this shift from public financing of Social Security benefits to private financing of higher retirement benefits would represent the *greatest reduction of government spending in world history*.

Once the personal accounts are phased in to assume responsibility for paying future benefits, the payroll tax – the highest tax working people pay – can be eliminated altogether. *That would amount to the greatest tax cut in world history.*

Personal accounts would fundamentally transform Social Security from a mere tax and redistribution, pay-as-you-go system to a fully funded, savings and investment system. In the process, the unfunded liabilities of Social Security would be eliminated entirely.

Personal accounts should be recognized as the only real solution for Social Security, rather than trying to tweak age requirements and tax rates and benefit levels, none of which works to pay higher and better benefits for working people. Rather, such tweaking only makes Social Security an even worse deal for working people, reducing the effective rate of return paid by the program even further. Eliminating the unfunded liabilities of Social Security would involve *the*

[13] Peter J. Ferrara, *supra* note 1.

greatest reduction in effective government debt in world history.

Why Social Security Is a Bad Deal

Why are the benefits payable through personal accounts 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.

Even when the system was running annual surpluses, close to 90 percent of the money coming in was paid out within the year to pay current benefits. Even the remaining annual surpluses were not saved and invested. They were lent to the federal government and spent on other government programs – from foreign aid to bridges to nowhere, with the Social Security trust funds receiving only internal federal IOUs promising to pay the money back when it is needed to pay benefits. The Social Security "trust funds" hold nothing but internal federal IOUs now totaling roughly $2.7 trillion.

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 immediately redistributed to other people in benefits and other government spending. In the process, nothing is created and nothing is produced, as occurs with real savings and investment.

Real savings and investment is capital, which allows businesses to expand and new businesses to be established, creating new jobs and equipping workers with modern technology to help them be more productive. In the process, real economic growth is created. More is produced. Gross domestic product is increased. That economic growth – increased production of real goods and services, increased gross domestic product – finances the return to capital paid to investors. That return to capital accumulates and compounds, year after year, growing over a lifetime of savings and investment.

When Albert Einstein was asked to identify the most powerful force in the universe, the inventor of the atomic bomb and nuclear energy is said to have 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 standard, long-term market-investment returns, two-earner average-income couples investing in their own personal accounts what they and their employers are otherwise required to pay into Social Security over their careers would retire with close to $1 million in their accounts. Such investment returns are achieved through readily available market index funds.

Moreover, the full social gain to be achieved by 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 in 1996.[14]

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 is 9.5 percent.

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

[14] Martin Feldstein, "The Missing Piece in Policy Analysis: Social Security Reform," *NBER Working Paper No. 5413*, National Bureau of Economic Research, January 1996.

is made and no economic growth or increased production is produced, and so no market investment returns are created or earned. Simply "moving money around" through taxes and redistribution does not create or produce anything, so workers lose the compounding real returns of real saving and investment. They lose Einstein's most powerful force in the universe.

The IOUs held in the Social Security trust funds are 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 rather liabilities to be paid by federal taxpayers. As a 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 back those IOUs. The real problem is that it's going to be hell – for you, the taxpayer – 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 over to the U.S. Treasury some of those trust-fund IOUs, in order to get money 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, they are owed by you, and 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 each year into Social Security. When Social Security comes to the Treasury turning in 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.

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 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.[15] That is in addition to continuing payroll taxes. Under current Social Security financing, today's working generation essentially will have to pay twice for their retirement.

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 these days is facing political challenges as well as economic challenges due to long-term economic stagnation. Combined, these factors suggest Social Security's tax and redistribution, pay-as-you-go system can pay a return 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[16] 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

[15] 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.

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

female workers each year. They have two children and they each started working in 1985 at age 22, right after they graduated from college.

Even if all their promised Social Security benefits were 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 get 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.

Moreover, these Social Security returns do not represent actual investment returns resulting from, and financed by, increased economic growth. They represent and result from *redistribution* over time. Those redistribution returns can never remotely hope to keep up with the *produced* returns that are created 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 what Social Security already is for many people today. Some workers today, along with their employers, are paying more than $10,000 a year, each and every year, into Social Security. Instead of getting any real interest on that money, they are losing money on it every year with a negative real rate of return.

This is where Social Security is heading for *all* workers in the future. If the government raises taxes, 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 all workers across the board. Eventually, virtually all workers under Social Security would be driven down into the range of negative effective real returns.

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 invested to finance his or her future benefits.

In his book *Stocks for the Long Run*, Jeremy Siegel 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.[17] It was also 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.[18]

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 diversified portfolio of 90 percent Large Cap and 10 percent Small Cap stocks earned a 9.36 percent real return over that period – a period that *includes the 2008 financial crisis.*

Over the entire postwar era, since 1946 in the United States, corporate bonds have averaged a real return of 4 percent.[19] Harvard University professor Martin Feldstein, 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

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

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

[19] Edgar K. Browning, "The Anatomy of Social Security and Medicare," *The Independent Review* **XIII** (Summer 2008): 12. See also, Siegel, *supra* note 16 (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.

bonds would have generated a real return of 5.5 percent since 1946, and the same return over the period going back to 1926.[20]

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

Documenting the Problem

The non-partisan Tax Foundation conducted the calculations below for a study comparing the benefits that could be paid through personal accounts with the benefits promised by Social Security.[21] The results were calculated for different hypothetical family combinations, with varying:

- family composition – single or married, with or without children, one-earner or two-earner couples;
- work histories – low wage starting work after high school, middle income 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; and
- investment strategies – 60 percent stocks and 40 percent bonds, 100 percent stock index funds.

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 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, examining families entering the work force today to retire 45 to 50 years into the future, earning average future returns based on past experience. Earnings histories were 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.

These calculations demonstrate two critical truths:

(1) The retrospective calculations – involving families retiring today after a lifetime of savings and investment earning the actual returns in the market over the past 45 to 50 years – include the entire period and experience of the 2008–09 financial crisis and recession. Yes, there were investment losses and poor returns during that period. But while the economy never recovered,[22] investment markets did. That is why the hypothetical middle-income families in this study reach retirement today after a lifetime of savings and investment, which also includes the market boom of the 1980s and 1990s, *with a million dollars or more at retirement*. The simple-minded claims that a system of personal accounts would have been destroyed by the financial crisis are false.

In fact, that period, including the financial crisis, serves as a worst-case scenario for a

[20] Martin Feldstein and Andrew Samwick, "The Economics of Prefunding Social Security and Medicare Benefits," *NBER Working Paper No. 6055*, National Bureau of Economic Research, June 1997.

[21] Stephen J. Entin, "Comparing the Returns from Tax-Favored Retirement Plans to Social Security Yields," Tax Foundation, June 8, 2016, http://taxfoundation.org/article/comparing-returns-tax-favored-retirement-plans-social-security-yields.

[22] Peter J. Ferrara, "Why the United States Has Suffered the Worst Economic Recovery Since the Great Depression," *Heartland Policy Brief*, The Heartland Institute, August 2016.

system of personal accounts. The 10 years from 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 opponents to reform claim. The truth 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 demonstrated not just by theory but by personal account retirement systems already in place around the world, which all suffered downturns during the financial crisis but rebounded to new heights of prosperity afterwards.

(2) The prospective calculations, involving young workers entering the work force 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. Even more of these workers and their families would retire as millionaires in the future with personal accounts.

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 of dollars over the years accumulating in the personal accounts of working people.

Two-Earner Couple

An important case to examine closely is the average income, two-earner couple, where the husband and wife both started working out of college at age 22 in 1971, each earning 100 percent of median income over their careers, and retired at the normal retirement age of 66 in 2015. They invest 10 percent of taxable wages in their personal account each year in a stock index fund, and earn the exact investment returns that the markets paid each year since 1971, including during the financial crisis in 2008–09 and during all other downturns and bouts of inflation in those years.

This average income two-earner couple would reach retirement with more than $2 million – $2,005,205 – in their personal account. The promised Social Security benefit for this couple is $39,293 each year. Their personal account would be sufficient to finance an annuity paying them $159,707 each year for the rest of their lives, *four times as much as Social Security even promises, let alone what it can pay.* The couple could also choose to keep their personal account funds invested 60 percent in stocks and 40 percent in bonds throughout retirement; at a 5.5 percent real return each year, they would earn $110,286 in investment returns each year for life, nearly three times what Social Security even promises. *This would enable them to keep the $2 million in their personal account intact to be left to their children at death.*

Lower-Middle-Income Couple

A two-earner couple where one spouse earns career income around 100 percent of median income and the other spouse earns career income of just 45 percent of median income *would retire as millionaires,* with a personal account of $1,477,006, after investing 10 percent of taxable wages over their career in a stock index fund.

Social Security promises to pay them $31,570 in benefits each year, but the personal account would finance an annuity paying them nearly four times (3.72) as much at $117,638 every year for life. Or they could continue to invest the million-dollar fund throughout retirement, 60 percent in stocks and 40 percent in bonds, earning a 5.5 percent real return on average. They would then receive $81,235 in investment returns each year for life, *2½ times (2.57) what Social*

Security promises, while preserving their $1.5 million fund intact to leave to their children.

Even a couple with one average-income spouse married to a roughly minimum-wage worker earning 25 percent of the median income *would reach retirement with more than a million dollars,* $1,266,559*,* again investing 10 percent of taxable wages over their career in a stock index fund. That would finance an annuity each year of $100,876 for life, well over 3 times (3.42) the $29,470 Social Security promises to pay them. Or they could keep investing the fund, 60 percent in stocks and 40 percent in bonds, earning a 5.5 percent real return on average, which would pay them $69,660 in investment returns each year for life, *2⅓ times (2.36) what Social Security promises*, enabling them to leave the $1.26 million fund to their children.

Low-Income Couple

Consider a low-income two-earner couple, with one spouse earning 25 percent of median income, essentially a career minimum-wage earner, and the other spouse earning 45 percent. Both start working after high school at age 18, investing 10 percent of income each year in a stock index fund.

They would reach retirement with nearly three-quarters of a million in their personal account ($738,360). That fund would pay them an annual annuity of $58,807, *nearly 3 times* (2.79) the $21,035 Social Security promises. If they continued to invest the personal account throughout retirement, 60 percent in stocks and 40 percent in bonds, they would achieve investment returns of $40,610 each year, *twice (1.93 times) what Social Security promises,* leaving the three-quarter million dollars intact for their family and children.

Upper-Middle-Income Couple

All two-earner couples earning above-average incomes would retire with roughly $2 million to $3 million in their personal accounts. All two-earner couples with just one of the two earning 300 percent of median income – basically the maximum taxable income for Social Security (successful professionals) – would retire with $2 million to $4 million.

Let's examine upper-middle-income couples more closely. Take the couple where one earns the median income and the other earns 160 percent of the median. Investing 10 percent of taxable wages in a stock index fund, *they would reach retirement with $2.6 million ($2,606,662) in their personal account*. That would pay them an annual annuity of $207,610, more than five times (5.47) the $37,961 Social Security promises. They could also choose to keep investing the personal account funds, 60 percent in stocks and 40 percent in bonds, earning investment returns of $143,366 each year, *still close to 4 times (3.78) what Social Security promises*, enabling them to leave the $2.6 million fund to their children.

Or take the couple where both earn 160 percent of the median. *They would reach retirement with $3.2 million ($3,208,119)*, which would pay them an annual annuity of $255,514, *nearly 5 times (4.9) the $52,075 Social Security promises*. Or they could continue investing the fund throughout retirement, 60 percent in stocks and 40 percent in bonds, with continuing annual returns of $176,447, which is *3.4 times what Social Security promises*, and still leave the $3.2 million fund to their heirs.

Today's Young Worker

Young people entering the work force today would benefit the most from personal accounts. Let's look at our middle-income, two-earner income couple again. Say they both enter the work force in 2015 at age 22 just out of college, earn 100 percent of median income throughout their careers, and retire at the normal retirement age of 67 in 2060, investing 10 percent of taxable wages each year throughout their careers in a stock index fund through their personal account.

They would reach retirement as multi-millionaires, with a personal account fund of $2,691,351 in 2015 dollars adjusted for inflation. That would pay them an annual annuity of $205,018, *3 times the $69,173 Social Security promises* to pay them by then, but which under

the projections of the Social Security actuaries the program will not be able to pay. Alternatively, the couple could continue to invest their personal account funds throughout retirement, 60 percent in stocks and 40 percent in bonds, earning a standard long-term real return of 5.5 percent. That would yield an annual investment payout of $148,024, again in today's dollars, more than *twice (2.13) what Social Security promises them, but cannot pay*, while allowing the couple to leave the $2.7 million account to their family and children or other chosen heirs.

Or consider a more modest-income, two-earner couple, with one starting work just out of high school at age 18 earning 45 percent of median income over his or her career, and the other starting work just out of college at age 22 earning around 100 percent of median income. investing 10 percent of taxable payroll in stock index funds, they would retire at age 67 in 2060 *as multi-millionaires as well, with $2,000,944 in their account*, again in 2015 dollars adjusted for inflation. That would pay them an annual annuity of $152,425 in 2015 dollars, *nearly three times (2.74) the $55,560 Social Security promises the couple, but cannot pay.* Or the couple could continue to invest their personal account throughout retirement, 60 percent in stocks and 40 percent in bonds, earning a 5.5 percent real return. That would provide an annual investment payout of $110,052, *double what Social Security promises the couple*, which would enable them to leave the $2 million personal account to their heirs.

Finally, consider a low-income couple with both spouses starting work in 2015 just out of high school at age 18, one earning around 25 percent of the median income and the other earning around 45 percent of the median income. They invest 10 percent of their taxable income each year in a stock index fund, retiring at the normal retirement age of 67 in 2064.

At retirement, this low-income couple would retire as millionaires with $1,020,136 in their personal account. That would finance an annual annuity of $77,711, *double (2.1) the $36,998 Social Security promises them, but cannot pay.* Alternatively, the couple could continue investing the personal account funds in retirement, 60 percent in stocks and 40 percent in bonds, with an annual investment payout of $56,107, *still 152 percent of what Social Security promises them but cannot pay*, while enabling this lower-income couple to leave the million dollars to their heirs at death.

Single Workers

The single median-income worker in the Tax Foundation study starts work out of college at age 22 in 1971, earns the median income over his career, and retires at the normal retirement age of 66 in 2015. He invests 10 percent of taxable wages each year in his personal account in a stock index fund, earning the actual returns earned in the markets each year throughout his career, including during the financial crisis in 2008–09 and all other downturns, recoveries, and bouts of inflation during those years.

He reaches retirement as a millionaire, with $1,002,603 in his personal account. That would finance an annual annuity of $79,853, *four times the annual retirement benefit of $19,646 Social Security promises him.* Or he could continue investing 60 percent in stocks and 40 percent in bonds each year of his retirement, with the annual 5.5 percent real return on average paying him $55,143 each year, *nearly 3 times (2.8) what Social Security promises*, leaving the million dollar fund intact to be left at death to his heirs.

The single worker earning the maximum-taxable income over her career – about 300 percent of median income – investing 10 percent in a stock index fund over her career, *would reach retirement as a multi-millionaire with $2,100,654,* even assuming she enters the work force at 26 after a professional education. That fund would finance an annual annuity paying her $167,309, 3½ times the $47,509 Social Security promises. Or she could continue to invest the funds throughout retirement 60 percent in stocks and 40 percent bonds, paying her a continuing annual return of $115,536, *more than 2.4 times what Social*

Security promises, and still leave the nearly $2.1 million fund to her heirs.

Or consider a single lower-income worker starting work out of high school at 18 in 1968, earning 45 percent of median income and investing 10 percent in a stock index fund over his career. *This lower income worker would reach retirement in 2016 with a personal account fund of $474,403*, nearly half a million dollars. *That would pay him an annual annuity for life of $37,784, more than three times (3.17) the $11,923 Social Security promises.* Or the worker could continue to invest his personal account funds throughout retirement, 60 percent in stocks and 40 percent in bonds, earning continuing investment returns of $26,092 each year, *more than twice (2.19 times) what Social Security promises*, and still leave the nearly half million to his family and children at death.

Young workers entering the work force today would again do even better saving and investing for a lifetime with personal accounts. *The median income worker* investing 10 percent in a stock index fund each year *would reach retirement in 2060 with $1,345,675 in his personal account*, in 2015 dollars adjusted for inflation. That would finance an annual annuity of $102,509, again in today's dollars, *three times the $34,587 Social Security promises to pay him but will not be able to pay.* Or the worker can choose to continue to invest his personal account throughout retirement, 60 percent in stocks and 40 percent in bonds, earning an annual investment return on average of *$74,012, double (2.13 times) what Social Security promises to pay.* That would enable him to leave the $1.3 million plus personal account funds to his heirs.

The more successful worker earning 300 percent of the median over her career, investing 10 percent in a stock index fund each year, *would reach retirement in 2060 as a multi-millionaire with $3,061,876 in her personal account*, even assuming she entered the work force at age 26 after a professional education. That would finance an annual annuity of $233,243 in today's dollars, *more than four times the $56,111 Social Security promises to pay.* If she continues to invest her personal account funds through retirement, 60 percent in stocks and 40 percent in bonds, she would earn an annual investment return on average of *$168,403* in today's dollars*, three times what Social Security promises but will not be able to pay*. That would enable her to leave the $3 million plus fund to her heirs.

A lower-income worker earning 45 percent of median income, investing 10 percent in a stock index fund each year, would reach retirement in 2060 with a personal account fund of *$655,269, two-thirds of a million dollars.* That would finance an annual annuity of $49,916, 2½ times the $20,973 Social Security promises but will not be able to pay. Or the worker can continue to invest throughout retirement, 60 percent in stocks and 40 percent in bonds, earning an annual investment return on average of $36,040, *close to twice (1.72 times) the $20,973 Social Security promises to pay*. That would leave the nearly two-thirds of a million dollars intact for heirs.

One-Earner Couples

Social Security provides the best relative deal to one-earner couples, paying for the retirement of two people while only one works and pays taxes into the program. But even these workers and their families would gain far higher benefits if they were to save and invest over their careers through personal accounts, with most retiring as millionaires as well.

The one-earner couple where the worker earns 100 percent of the median income and invests 10 percent of taxable income in a stock index fund *would reach retirement as a millionaire, with $1,002,603 in a personal account.* That fund would pay a *lifetime annual annuity of $79,853, which is 2.7 times the $29,470 Social Security promises the couple.* Or the couple could continue to invest the personal account throughout retirement, 60 percent in stocks and 40 percent in bonds, earning an annual investment return on average of *$55,143, nearly twice (187 percent) what Social Security promises to pay the couple*, while still allowing them to leave the $1 million fund to their heirs.

Among lower income workers, the one-earner couple where the worker earns 45 percent of the median income, and invests 10 percent in a stock index fund each year, reaches retirement with *$474,403 in a personal account.* That would pay a *lifetime annual annuity of $37,784, more than twice (2.11 times) the $17,885 that Social Security promises the couple.* Or the couple could continue to invest the fund throughout retirement, 60 percent in stocks and 40 percent in bonds, earning an annual investment return of *$26,092, still 146 percent of what Social Security promises to pay*, while allowing them to leave the half-million dollar fund to their heirs.

One-earner couples entering the work force today would do even better with a lifetime of savings and investment through personal accounts. The one-earner couple where the worker earns *100 percent of the median income*, investing 10 percent of taxable income in a stock index fund, would reach retirement at age 67 in 2060 as *a millionaire with $1,345,675 in a personal account.* That fund would pay the couple in retirement an annual annuity of *$102,509, double the $51,880 Social Security promises but will be unable to pay.* Or the couple can continue to invest the account funds and live off of the returns in retirement, keeping the $1.345 million retirement account intact. Investing 60 percent in stocks and 40 percent in bonds, the couple would earn *investment returns of $74,012 each year, still 142 percent what Social Security promises them but cannot pay.* They would then be able to leave the nearly $1.4 million account to their heirs at death.

Survivors and Disability Benefits

For the calculations above, those who chose the personal accounts were assumed to continue to receive disability benefits from Social Security. When workers pass away before retirement, they would leave behind a lifetime of savings and investment in their personal accounts that would be able to self-fund far more than the survivors benefits even promised by Social Security, let alone what Social Security would be able to pay.

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 then far more – especially since Social Security pays full survivors benefits before retirement only if the worker leaves behind children younger than 18 or attending college. No survivors benefits before retirement are paid for childless couples; in the case of single workers, no survivors benefits are paid even to the families of those who pass away after retirement.[23]

For modest amounts, workers could purchase term life insurance to supplement what is accumulated in their personal accounts until the account holds enough to pay at least the survivors benefits that Social Security promises. Even during the first 10 to 15 years of work, the amount of coverage needed in that supplemental life insurance policy would decline as the personal account funds grow.

A Proposal for Reform

The calculations above make it clear legislation should be adopted empowering all working people age 40 and below with the freedom to choose personal savings, investment, and insurance accounts to finance their future Social Security retirement and survivors benefits. Workers who made that choice would be free to direct 10 percentage points of their Social Security payroll taxes into their personal accounts. They would be free to make investment choices for those accounts ranging, from 100 percent stock index funds to 50 percent stock index funds/50 percent bond index funds. Some account funds would be used to purchase life insurance sufficient to pay survivors benefits at

[23] For small amounts for a few years, younger workers are free to buy term life insurance to ensure coverage for survivors benefits to the extent they wish to do so before their fund grows to sufficiently large amounts to self-fund more in survivors benefits than Social Security even promises.

death, at least equal to what Social Security promises to pay the worker.

Workers also would be free to forego the personal accounts altogether and rely solely on 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. This is feasible because personal accounts are obviously a better deal than Social Security. The Chief Actuary of Social Security concluded as much when scoring U.S. Rep. Paul Ryan's personal account proposal in 2004 and 2005: He assumed 100 percent of all workers would choose the personal accounts. 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 not be imposed on anyone; they would be offered as a choice for working people on an individual basis. Those who did not want to choose the market option would be perfectly free to stay in Social Security as is, with no change. They alone would 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.

At retirement, workers would be free to use some or all of the accumulated funds to finance annuity benefits for the rest of their lives, or to live off of the investment returns from continuing investment of the personal account funds and leave some or all of the personal account funds to heirs. Workers who were free to choose such personal accounts for their entire careers would receive the benefits payable through the accounts for their retirement and survivors benefits. Workers who were already in the work force when the personal account option became legal would also receive the Social Security retirement and survivors benefits that they had already paid for through past payroll taxes.

All disability benefits would continue to be paid through Social Security, at least for now, with the future possibility of providing for disability benefits to be paid through private disability insurance. The personal accounts also could be expanded in the future to provide additional annuities that could be used to purchase private health insurance, as chosen by each retiree, that would cover the liabilities of Medicare, providing an additional option to senior citizens through Medicare. House Speaker Paul Ryan has already proposed Medicare reforms extending to all of Medicare the choices available under Medicare Parts C and D. Personal accounts for Medicare can be designed to complement the Ryan reforms.

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. 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 very feasible and unlikely to ever be needed.

The personal accounts would be free of any federal, state, and local taxes interfering with the reform and achievement of its goals. That would mean no taxation of the build-up of personal account investment returns, no taxation of the benefits payable by the personal accounts, and no taxation by the death or estate tax of personal account funds left for the worker's hears.

The Transition

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

The transition financing represents a transitional cash flow issue, not a transition "cost." Saving and investment are not a *cost* of the reform, but a *benefit* from it.

Consider this example: 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, you can't have your cake and eat it too; you can't spend the $2,000 in addition to saving it. But that is true of any savings increase.

The necessary transition financing would be achieved ideally through reduced government spending resulting from other necessary entitlement reforms.[24] The funds freed up by reduced government spending could be devoted to financing the transition to personal accounts, which means financing continued Social Security benefits during the transition. Those needed 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.[25] With taxpayers currently spending $1 trillion a year on welfare, and more than $2 trillion to $3 trillion a year on Obamacare, Medicare, and Medicaid, more than enough can be saved to finance the transition to personal accounts.[26]

Alternatively, the transition could be financed, at least in part, through borrowing some of the increased savings produced through the personal accounts themselves. That would help finance the transition while still allowing for a substantial pro-growth increase in savings and investment.

Conclusion: The Only Real Solution

Fully funding Social Security through personal savings, investment, and insurance accounts is the only real solution to 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.

Moreover, through such personal accounts, retirees of all income levels and family combinations would receive much higher benefits and substantial lifetime accumulations of wealth. Those lifetime accumulations of wealth would do far more to reduce inequality than any policy ever proposed, ultimately providing trillions of dollars in accumulated wealth to working people across America.

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

There is no alternative to solving the $210 trillion "fiscal gap"[27] other than by undertaking to fully fund these programs. We cannot, and should not, address that gap through $210 trillion in tax increases and benefit cuts.[28] To do so would collapse the U.S. economy, and, indeed, our entire democratic system.

[24] Peter J. Ferrara, *supra* note 1.

[25] *Ibid*.

[26] *Ibid*.

[27] Laurence J. Kotlikoff, "America's Hidden Credit Card Bill," *The New York Times*, July 31, 2014, https://www.nytimes.com/2014/08/01/opinion/laurence-kotlikoff-on-fiscal-gap-accounting.html.

[28] One proposal would change the fundamental Social Security benefit formula through what is called "price-indexing." This would change the basic benefit formula so that by the time today's young workers retire, they would be entitled to only 70 percent or so of currently promised benefits. At that time, Social Security would have enough funds to pay only about 70 percent of the promised benefits, so price indexing "solves" the problem and balances the Social Security budget. But merely balancing the Social Security budget, while driving everyone on Social Security down into negative real returns, is not the goal.

About the Authors

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About the National Tax Limitation Committee

The National Tax Limitation Committee (NTLC) was organized in 1975. Its mission is to provide national leadership to achieve the optimal size and functions of government and promote candidates and initiatives that support these goals.

NTLC and its foundation, the National Tax Limitation Foundation (NTLF), have organized numerous conferences and seminars around the nation on critical issues. Uhler speaks regularly at the annual Conservative Political Action Conference (CPAC) in Washington, sponsored by the American Conservative Union (ACU), on whose board he served for many years. NTLC's operating philosophy has always been to partner with other groups and individuals in the accomplishment of mutual goals. NTLC and NTLF are further supported by a distinguished Board of Advisors.

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