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CRS Report Says Government Investment Won't Save Social Security

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When the new Congress takes up the issue of Social Security reform, it should not consider plans that would allow the federal government to invest Social Security trust fund dollars in the stock market. Not only would this bring a portion of the economy under direct political control, but as a recent nonpartisan Congressional Research Service (CRS) study entitled *Social Security Reform: Projected Contributions and Benefits Under Three Proposals* clearly shows, government investment simply will not work. The CRS found that in 2032, without any new action by Congress, either Social Security benefits will have to be cut by 27 percent or Social Security taxes will have to be raised by 40 percent. (The study assumed that the existing trust fund would be repaid on schedule in order to allow benefit payments until then.)

The December 1998 CRS study compared a July 1998 plan put forth by Robert M. Ball, former Commissioner of the Social Security Administration, with the plans spelled out in two bills introduced during the 105th Congress (S. 1792 and S. 2313/H.R. 4256). The Ball Plan would allow government investment of the Social Security trust fund, while the bills would allow workers to invest a portion of their Social Security retirement taxes in individually owned, privately managed accounts. The CRS concluded that the Ball Plan would not solve Social Security's long-term financial problems, but the plans establishing individual accounts would restore the overall Social Security system to financial health.

CRS Criticism of the Ball Plan. The Ball Plan would require the government to invest up to 50 percent of the Social Security trust fund in stocks. It would also raise Social Security taxes by assessing 90 percent of wages from covered employment. It would end the exemption that allowed some state and local governments to opt out of Social Security and, after a 10-year transition period, would force all newly hired state and local government employees into the Social Security system. And it would allow workers to pay an additional 2 percent of income into a voluntary individual account that would be invested in stocks and bonds. It also assumes that cost of living allowances (COLAs) would be reduced.

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The CRS reported that the Ball Plan would not work without risky investments. About 54 percent of the Ball Plan's long-term remedy for Social Security's problems would come from government's investing half of the trust fund in the stock market. The rest would remain in special issue government bonds. However, when the CRS assumed that these

investments earned an annual return of 6.4 percent, it found that "Under this scenario, the Ball Plan would not eliminate the long-range deficit."

The only way the Ball Plan would work is if its stock market investment of 50 percent of the trust fund earned an average return of 10.7 percent annually. Otherwise, the CRS noted, "Assuming a smaller return would mean that the system would not be fully financed over the long run, and additional changes—such as revenue increases or benefit cuts—would need to be considered."

CRS Findings on Individual Accounts. According to the CRS analysis, the 21st Century Retirement Act (S. 2313/H.R. 4256), introduced by Senators Judd Gregg (R–NH) and John Breaux (D–LA) and Representatives Jim Kolbe (R–AZ) and Charles Stenholm (D–TX), would solve Social Security's long-term financial problems while paying higher individual retirement benefits. The bill requires mandatory individual Social Security accounts financed by the portion of Social Security taxes that is equal to 2 percent of income. The Social Security Solvency Act (S. 1792), introduced by Senators Daniel Patrick Moynihan (D–NY) and Robert Kerrey (D–NE), would allow voluntary individual accounts, pay somewhat lower individual benefits, and prevent the program's long-term problems. Neither plan includes any form of government investment of the Social Security trust fund.

Other Problems with the Ball Plan. In addition to the weaknesses in the Ball Plan identified by the CRS, there are other problems with government investment of the Social Security retirement trust fund, including:

- **Higher taxes that would lower the rate of return.** Raising Social Security taxes might bring more money into the system, but it would also make Social Security an even worse deal for American workers. Social Security's annual rate of return is already less than 1.5 percent for most younger Americans. Raising their taxes only makes their rate of return worse. Even though workers who pay higher taxes will get slightly greater retirement benefits (since their benefits are based on taxable income), the increase would be so low that their overall rate of return would still decline.

- **Increases in Social Security's obligations.** Ironically, even though raising taxes on workers would bring in more money now, current law will require Social Security to pay higher benefits to these workers when they retire. Retirement benefits are based on the level of income on which Social Security taxes are paid, and making workers pay taxes on more of their income means that they will get a bigger retirement check. This will increase the system's liabilities and make it even harder to save.

- **Political control of the economy.** Allowing the federal government to own stock in private companies could bring those companies under political control. The stock of most major U.S. companies is so widely dispersed among investors that a mere 2 percent to 3 percent ownership bloc is enough to influence corporate policy substantially. Investing half of the Old-Age and Survivors Insurance trust fund in stocks would allow the government to own up to 10 percent of the stocks listed on the New York Stock Exchange.

- **Conflicts of interest.** Pension fund trustees are legally required to make investment decisions only for the financial benefit of their members. But there are numerous examples of political interference in the pension funds of state and local government employees, ranging from forced investment in "worthwhile" causes to refusing to buy the stock of certain types of companies or investments located in certain countries. Political influence will force those investing the Social Security trust fund to choose between the interests of American workers and those of politicians.

The Ball Plan is a bad idea in many ways, and as the CRS report shows, it simply will not work. Congress should not consider allowing the government to invest the Social Security trust fund.

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NOTE: Nothing written here is to be construed as necessarily reflecting the views of The Heritage Foundation or as an attempt to aid or hinder the passage of any bill before Congress.