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The Mueller Social Security Report Is Flawed

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Are reduced Social Security benefits better for the average retiree than a personal retirement account? According to a 140-page report published by economist John Mueller of Lehrman Bell Mueller Cannon, Inc., in cooperation with the Employee Benefits Research Institute and Policy Simulation Group, the answer is "yes." Unfortunately, the Mueller report's conclusions are based on faulty assumptions and contrived scenarios.

The Mueller report, which was commissioned by the National Committee to Preserve Social Security and Medicare, an advocacy group on retirement and senior citizens issues, has many flaws, including unrealistic assumptions about long-term stock market investments, an unsupportable adjustment for investment risk, and a contrived way to pay for the transition to a Social Security system featuring personal retirement accounts. For example:

- **The report assumes that virtually every other economist has been wrong about the stock market.** For 200 years, economists have held that supply and demand determine earnings on investments in stocks. People will invest in stocks only so long as the amount they earn from that investment is more attractive than the alternatives. When it is not, they invest in something else or spend the money they would have invested. Since 1900, investors have demanded and received earnings from stocks that average 7 percent per year after inflation. Studies by both the Social Security Administration (SSA) and the bipartisan Advisory Council on Social Security project that stocks will continue to earn an average of 7 percent annually. Mueller characterizes these studies as "deeply flawed" and "seriously misleading" despite findings by the Office of Management and Budget and the Congressional Budget Office that also project an annual return of 7 percent.

  Mueller insists long-term earnings from stocks are determined by the economy's overall growth rate. Because the economy is predicted to grow more slowly in the future, Mueller maintains that stocks will earn only 4.7 percent after inflation. But this outcome would require a sudden and fundamental change in investors' behavior. After a century of demanding a 7 percent average annual return from stocks, Mueller predicts Americans will settle for a 4.7 percent return. This assumption, of course, drastically reduces the expected returns from personal retirement accounts.

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- **The report makes an unsupported adjustment for risk.** Mueller uses a curious

measurement of investment risk to reduce the expected average earnings of both stocks and Social Security benefits. Even though the SSA reports it will have enough revenue in 2032 to pay only 72 percent of the benefits it has promised (making Social Security a highly risky "investment" by any standard), Mueller states that investing in stocks is almost five times *more* risky than Social Security, so he reduces his already low projection of earnings from stocks by another 2.9 percent while reducing those from Social Security by only 0.6 percent.

Risk is an important concern, and it is legitimate to include an adjustment. But Mueller's is excessive. Although stocks are volatile over short-term periods, Professor Jeremy Siegel of the Wharton School of Business at the University of Pennsylvania finds that over a 20-year period, stocks are no more risky than treasury bonds (the equivalent of Social Security Trust Fund reserves). Moreover, a study by Ibbotson Associates finds that stocks have gone up in value in every possible 20-year period between 1926 and 1998 that it examined (there were 54 such periods). Investments for retirement usually are held for more than 20 years.

- **The report selects an unreasonable transition plan.** The Mueller report also overstates the transition costs of moving to a system of personal retirement accounts. It ignores many of the proposed plans and instead uses a contrived example that is unrealistic and improbable. Initially, Mueller's chosen transition plan would raise Social Security taxes temporarily by 20 percent, with the additional money going into personal accounts. Only a few of the nearly 30 plans that call for personal retirement accounts include such a provision. In later years, Mueller assumes transition costs would be funded on a pay-as-you-go basis from Social Security revenues. In other words, annual Social Security taxes would have to be high enough to pay for personal retirement accounts *and* all benefits promised under the current system. Mueller also does not consider recent plans that call for using most of the overall budget surplus to preserve Social Security.

Mueller assumes that the entire transition cost would be paid in one generation, instead of two or more as called for in most serious reform plans. Responsible transition plans consider it unfair to force one generation to fund both its own retirement benefits and those of the previous generation. Hence, reformers generally propose that paying off Social Security's large unfunded liability should be spread over many years through bonds paid for by the following generation. Although this method would lengthen the transition time, it also would reduce the burden on the first generation.

MUELLER'S PLAN: CUT SOCIAL SECURITY BENEFITS

Instead of creating private accounts, Mueller's solution to Social Security's problems is a 20 percent reduction in retirement benefits and Social Security taxes. Mueller claims this approach is superior because

> if the economy turns out to be better than now expected, the phasing-in of benefit scalebacks can be halted at any time...or else payroll tax rates could be permanently reduced below current law.

In reality, this is the worst solution. With a 20 percent cut in benefits, millions of lower-income workers who depend on Social Security for the vast majority of their retirement income would be left well below the poverty line. Also, even with a tax reduction, Mueller's estimates show these workers facing an absurdly low rate of return—less than 1.0 percent in some scenarios.

Over the past 60 years, Social Security has played a major role in reducing poverty in the elderly. Mueller's plan would reverse this trend, throwing millions of workers into poverty. Congressional decisions about the future of Social Security should be based on sound research and serious consideration of how each recommendation would affect working Americans. Unfortunately, the Mueller plan fails this test.

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