The Heritage Foundation Executive Memorandum

No. 717 February 6, 2001

Six Rules for Real Social Security Reform

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President George W. Bush's support for Social Security reform, together with strong public support for allowing workers to place some of their payroll taxes in personal retirement accounts, makes it much more likely that Congress will soon consider the issue. However, some lawmakers may be tempted to pass a band-aid that avoids the reforms necessary to assure real retirement security for future generations.

Social Security reform is too important to working Americans to allow short-term political considerations to triumph over sound policy. To qualify as real Social Security reform, a proposal must meet at least the following six criteria:

1. **The benefits of current retirees and those close to retirement must not be reduced.** Washington has a moral contract with those who currently receive Social Security retirement benefits, as well as with those who are so close to retirement that they have no other options for building a retirement nest egg. Unfortunately for seniors, the U.S. Supreme Court has ruled that they have no legal right to their benefits. This must be corrected. Any real reform plan must guarantee in law that seniors will receive every cent that the government has promised them, *including an accurate annual cost-of-living increase*.

   As a first step in saving Social Security for future generations, Congress should make sure that every already retired American has a contract that provides a legal guarantee of his or her Social Security retirement benefits. This should include a written U.S. Treasury–backed certificate specifying the level of guaranteed benefits. Furthermore, each American who reaches retirement age and applies for benefits should receive a similar contract.

2. **The rate of return on a worker's Social Security taxes must be improved.** Today's workers receive very poor returns on their Social Security payroll taxes. For example, an average two-earner couple in their early 30s will receive about 1.23 percent on their retirement taxes from Social Security. This is far less than the 3.40 percent (after inflation) that is paid on Series I U.S. Savings Bonds. As a general rule, the younger a worker is, the lower his or her rate of return will be. Meaningful reform must provide a better retirement income to future retirees without increasing Social Security taxes. The best way to do this is to allow workers to divert a portion of their existing Social Security taxes into a personal retirement account that could earn significantly more than Social Security could pay.

Produced by
The Domestic Policy Studies Department

Published by
The Heritage Foundation
214 Massachusetts Ave., N.E.
Washington, D.C.
20002–4999
(202) 546-4400
http://www.heritage.org

This paper, in its entirety, can be found at: *www.heritage.org/library/execmemo/em717.html*

3. **Personal retirement accounts that are part of Social Security should be funded by allowing workers to allocate some of their payroll tax dollars to them.** Using only promised surpluses to fund Social Security reform is not sufficient. If the government overspends—as it has done routinely in recent decades—working Americans will lose their chance for a secure retirement. Instead, Congress should divert a portion of the taxes that Americans currently pay for Social Security retirement benefits into personal retirement accounts. It should use the surplus to cover the short-term transition costs associated with this reform.

4. **Americans must be able to use Social Security to build a nest egg for the future.** A well-designed retirement system includes four elements: retirement income, stable payments, a safety net, and the ability to save. Workers should be able to use Social Security to build a cash nest egg that can be used to increase their retirement income or to build a better economic future for their families.

   Today's Social Security system provides a stable level of retirement income and protects against catastrophic losses, but it does not allow workers to accumulate cash savings to fulfill their own retirement goals or to pass on to their heirs. This gap needs to be filled. The best way to do this is to establish, within the framework of Social Security, a system of personal retirement accounts that are financed with a portion of the existing Social Security retirement taxes. The personal retirement accounts could be called "Social Security Part B," with the traditional version becoming "Social Security Part A."

5. **Personal retirement accounts must guarantee an adequate minimum income.** Seniors must be able to count on a reasonable and predictable level of monthly income, regardless of what happens in the investment markets. Therefore, in reforming the system, Congress should ensure that every American who chooses to have a personal retirement account receives a retirement income that is at least equal to what he or she would receive from the traditional Social Security program. Moreover, any funds manager who participates in a system of personal retirement accounts must give seniors a guarantee that their retirement income will at least be equal to what they gave up in traditional benefits. A retiree whose personal retirement account contains enough money to exceed the guaranteed benefit should be allowed to use the extra amount to increase his monthly income, take the excess in cash, or leave the money to his heirs.

6. **For current workers, participation in the new accounts must be voluntary.** No one should be forced into a system of personal retirement accounts. Instead, current workers must be allowed to choose between today's Social Security and one that offers personal retirement accounts. Americans who choose to divert part of their payroll tax into a personal retirement account should give up part of their traditional Social Security benefits in return for the higher earnings of a personal account. One way to accomplish this would be to require these workers to give up a portion that is at least equal to the amount of tax diverted. Thus, if a worker had 20 percent of his Social Security retirement taxes diverted into a personal retirement account, his government-paid Social Security check would be reduced by at least 20 percent. The difference would come from his personal retirement account.

Real Social Security reform should not only protect current retirees' benefits, but also provide higher retirement income for working Americans, regardless of whether Washington faces deficits or surpluses. The only effective way to ensure that Social Security can provide this income is to allow workers to invest a portion of their payroll taxes in personal retirement accounts.

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