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Six Important Rules for Real Social Security Reform

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President George W. Bush's continued 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 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. Thus, any real reform plan must guarantee in law that both retirees and those who are close to retirement will receive every cent that the government has promised them, *including an accurate annual cost-of-living increase.*

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 1.2 percent on their retirement taxes from Social Security. As a general rule, the younger a worker is, the lower his or her rate of return will be. Men born after 1963 actually end up paying more on average in Social Security payroll taxes than they will receive in benefits. Meaningful reform must therefore 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 can earn significantly more than Social Security can pay.

3. **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

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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 existing Social Security retirement taxes. If a worker died before retirement, his or her personal retirement account would become part of the estate, providing a nest egg that heirs could use for income, education, opening a small business, or donations to a church or charity.

4. **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 traditional Social Security. 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 or her monthly income, take the excess in cash, or leave the money to his or her heirs.

5. **Workers should be allowed to fund their Social Security personal retirement accounts by allocating some of their existing payroll tax dollars to them.** Workers should not be required to pay twice for their benefits—once through existing payroll taxes and again through additional income taxes used to fund a personal retirement account. Using only general revenues from the Treasury to fund Social Security reform is not sufficient. If the government overspends—as it has done routinely in recent decades—working Americans could 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.

6. **For currently employed workers, participation in the new accounts must be voluntary.** No one should be forced into a system of personal retirement accounts. Instead, currently employed 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. The personal retirement accounts could be called "Social Security Part B," with the traditional version becoming "Social Security Part A." For those who chose this option, their total Social Security retirement benefit would a combination of the traditional benefit and the proceeds of their 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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