Institute For Policy Innovation

IPI CENTER FOR ECONOMIC GROWTH

Personal Social Security Accounts That Work:

A Review of the Official Score of the Ryan-Sununu Social Security Plan

By Peter Ferrara

POLICY REPORT 185

NOVEMBER 2004

Executive Summary

The Chief Actuary of Social Security has scored the Ryan-Sununu Social Security reform bill, which provides for large personal retirement accounts, as achieving full and permanent solvency of the program without benefit cuts or tax increases. Eventually there would be substantially higher benefits as well as tax cuts. Additionally, the unfunded liability of Social Security would be eliminated.

Rep. Paul Ryan (R-WI) and Sen. John Sununu (R-NH) have introduced legislation providing for a large personal retirement account option for Social Security. The Chief Actuary of Social Security has scored this legislation as achieving full and permanent solvency of the program, without benefit cuts or tax increases.

Under the legislation, workers would be free to choose to shift their payroll tax money into personally owned individual retirement accounts. The maximum allowable amount would be 10 percentage points of their first $10,000 in wages each year, and 5 percentage points of all wages above that, to the maximum Social Security taxable income.

There would be no change in currently promised Social Security benefits of any sort. Social Security and the reform's transition financing are placed in their own separate Social Security Lockbox budget, with the surpluses protected and devoted to paying off all transition debt and then to reducing payroll taxes.

The transition would be financed by: the short-term Social Security surpluses; restraining the rate of growth of federal spending by 1 percentage point a year for each of eight years, and maintaining those savings until the transition financing is completed; increased tax revenues resulting from investing the personal account funds; and redeeming excess Social Security trust fund bonds financed by selling new federal bonds to the public.

The official score of the Chief Actuary shows that large personal accounts under Ryan-Sununu are sufficient to completely eliminate Social Security deficits over time. Not only would there be no benefit cuts or tax increases, but the accounts eventually would provide substantially higher benefits as well as tax cuts.

Because capital market returns are so much higher than returns that can be paid by the current non-invested Social Security framework, personal accounts would pay roughly two-thirds to 100 percent more in benefits than Social Security now promises workers in the future.

By the end of the 75-year projection period, instead of increasing the payroll tax to over 20 percent as would be needed to pay promised benefits under the current system, the tax would be reduced to 4.2 percent, enough to pay for all of the continuing disability and survivors' benefits. This would be the largest tax cut in world history. The bill includes a payroll tax cut trigger providing for this eventual tax reduction once all transition financing and debt obligations have been paid off.

The reform would eliminate the unfunded liability of Social Security, currently officially estimated at $11 trillion. This would be the largest reduction in government debt in world history.

After just the first 15 years of reform, the Chief Actuary estimates that personal accounts would accumulate to $7.8 trillion in today's dollars, dramatically broadening the ownership of wealth and greatly reducing the concentration of wealth.

Table of Contents

Direct all inquiries to:

Institute for Policy Innovation
1660 S. Stemmons Freeway, Suite 475
Lewisville, TX 75067

(972) 874-5139 [voice] Email: **ipi@ipi.org**
(972) 874-5144 [fax] Website: **www.ipi.org**

Personal Social Security Accounts That Work
A Review of the Official Score of the Ryan-Sununu Social Security Plan

By Peter Ferrara

Introduction

Rep. Paul Ryan (R-WI) and Sen. John Sununu (R-NH) have introduced legislation in the House and Senate providing for a large personal account option for Social Security. The Chief Actuary of Social Security has already scored the legislation as achieving full and permanent solvency in the program, without benefit cuts or tax increases. In fact, over the long run, large personal accounts would result in higher benefits than promised under current law, and lower payroll taxes. This is because market returns on real savings and investment are so much higher than returns on the non-invested, purely redistributive system of the current Social Security framework.

The Chief Actuary of Social Security has already scored the legislation as achieving full and permanent solvency in the program, without benefit cuts or tax increases.

The key point arising from the official score is that reform plans with large personal accounts like Ryan-Sununu do not need to make any changes in current-law benefit provisions, such as delaying the retirement age, or price indexing, to eliminate the long-term deficits of Social Security. The large accounts end up shifting so much of the current system's benefit obligations to the accounts themselves that the long-term deficits are eventually eliminated through this effect alone. Sophisticated advocates of personal accounts will recognize that this is a very powerful political argument for adoption of large accounts.

Moreover, because the Ryan-Sununu bill guarantees payment of at least the full benefits promised under current law, it offers a true prospect of winning broad, bipartisan support and passage. With that current-law benefit guarantee, the proposal retains the current defined benefits of Social Security as a backup to the personal accounts. If the defined-contribution benefits of the personal accounts are not higher than the current-law defined benefits of Social Security (even though they likely will be higher), then retirees will still get the current-law defined benefits.

The current Social Security system cannot pay the benefits promised under current law. But large personal accounts earning full market returns can do that and more.

The current, non-invested, pay-as-you-go Social Security system cannot pay the benefits promised under current law. But large personal accounts earning full market returns can do that and more—much more. Indeed, the bill offers enormous breakthrough gains in personal prosperity for working people, with a vast increase in personal wealth accumulating to $7.8 trillion (in today's dollars) in just 15 years, as well as ultimately much higher benefits and lower payroll taxes. That is why such reform should win the support of many liberals and Democrats, as well as conservatives and Republicans.

Below we review the key provisions of the Ryan-Sununu plan. We then review the results of the official score of that legislation by the Chief Actuary of Social Security. It includes a detailed analysis and explanation of the transition financing for the reform plan.

Major Provisions of the Ryan-Sununu Plan

Out of the 12.4 percent Social Security payroll tax, workers would be free to choose to shift money into personally owned individual retirement accounts. The maximum allowable amount would be 10 percentage points of their first $10,000 in wages each year, and 5 percentage points of all wages above that, to the maximum Social Security taxable income. This creates a progressive structure with an average account contribution among all workers of 6.4 percentage points.

- Benefits payable from the tax-free accounts substitute for a portion of Social Security benefits based on the degree to which workers exercise the account option over their careers. Workers currently in the workforce exercising the personal accounts continue to receive a portion of Social Security retirement benefits under the current system based on the past taxes they already have paid into the program. In addition to that, workers receive the benefits payable through the personal accounts.
- Workers choose investments by picking a mutual fund managed by major private investment firms, from a list of funds officially approved for this purpose and regulated for safety and soundness, which is similar to the operation of the Federal Employee Thrift Retirement System.

> ***Social Security and the reform's transition financing are placed in their own separate Lockbox budget. This means that government can never raid Social Security again.***

- The accounts are backed up by a safety net guaranteeing that workers receive at least as much as what Social Security promises under current law.
- Apart from this personal account option, there is no change in currently promised Social Security benefits of any sort, for today's seniors or anyone in the future. Those who choose to stay in Social Security receive the benefits promised under current law. Survivors' and disability benefits continue as under the current system unchanged.
- Social Security and the reform's transition financing are placed in their own separate Social Security Lockbox budget, apart from the rest of the federal budget. This means the government can never raid Social Security again to finance other government spending, achieving a goal long sought by many seniors. It also means the short-term transition deficits and the longer-term transition surpluses are apart from the rest of the budget, with the surpluses thereby protected and devoted to paying off all transition debt and then to reducing payroll taxes.

The Official Score of the Ryan-Sununu Plan

The official score of the Ryan-Sununu bill by the Chief Actuary of Social Security showed the following:

- The large personal accounts in the plan are sufficient to completely eliminate Social Security deficits over time, without any benefit cuts or tax increases. **That is because so many of Social Security's benefit obligations are ultimately shifted to the accounts.** As the Chief Actuary stated, under the reform plan, "the Social Security program would be expected to be solvent and to meet its benefit obligations throughout the long-range period 2003 through 2077 and beyond."[1] **Indeed, the eventual surpluses from the reform are large enough to eliminate the long-term deficits of the disability insurance program as well, even though the reform plan does not otherwise provide for any changes in that program.**

- Not only would there be no benefit cuts or tax increases. **Over time, the accounts would provide substantially higher benefits as well as tax cuts.** The official score shows that by the end of the 75-year projection period, instead of increasing the payroll tax to over 20 percent as would be needed to pay promised benefits under the current system, the tax would be reduced to 4.2 percent, enough to pay for all of the continuing disability and survivors' benefits. **This would be the largest tax cut in world history. The bill includes a payroll tax cut trigger providing for this eventual tax reduction once all transition financing and debt obligations have been paid off.**

An account invested two-thirds in stocks and one-third in bonds would pay workers over twice what Social Security currently promises.

- Moreover, as shown in a recent Institute for Policy Innovation study,[2] at standard, long-term market investment returns, the accounts would produce substantially more in benefits for working people across the board than Social Security now promises, let alone what it can pay. This is the only reform proposal that achieves that result. With personal accounts of this size, at standard long-term market investment returns, an account invested consistently half in corporate bonds and half in stocks would provide workers with roughly two-thirds more in benefits than Social Security promises (but cannot pay). An account invested two-thirds in stocks and one-third in bonds would pay workers over twice what Social Security currently promises.
- The reform would eliminate the unfunded liability of Social Security, currently officially estimated at $11 trillion, almost three times the current amount of national debt held by the public. This would be **the largest reduction in government debt in world history.**
- The reform would greatly increase and broaden the ownership of wealth and capital through the accounts. All workers would participate in our nation's economy as both capitalists and laborers. **Under the Chief Actuary's score, workers would accumulate $7.8 trillion in today's dollars in their accounts by 2020. Wealth ownership throughout the nation would become much more equal, and the concentration of wealth would be greatly reduced.**

The reform plan also would greatly increase economic growth, through reduced taxes and increased saving and investment. The result would be more jobs, higher wages, and faster-growing incomes and national GDP.

The plan would increase economic growth through reduced taxes and increased saving and investment.

The official score includes the estimated cost of the guarantee of current-law benefits in Ryan-Sununu. This cost is fully paid for in the financing provided in the bill. The Chief Actuary used the same methodology in scoring this cost as the official budget scorers do in scoring the cost of other government guarantees.

As with any guarantee, there is a moral hazard concern that those who enjoy the guarantee will take excessive risks: they will reap the gains if they succeed, but if they fail they will be protected by the guarantee from the losses. The Ryan-Sununu bill, however, avoids this moral hazard because the government retains complete control over what risks those with personal accounts can take. They only can choose government-approved investment funds for the personal accounts. Moreover, even within that framework, those who choose the riskier investment options can still suffer a large financial penalty, as only the currently promised Social Security benefits are guaranteed. But conservative investments that just earn the average market return would provide the worker with far higher benefits than what Social Security currently promises.

Conservative investments that just earn the average market return would provide the worker with far higher benefits than what Social Security currently promises.

Given this framework, the substantial cost for the guarantee estimated by the Chief Actuary is probably overstated. Workers only can choose among safe, highly diversified investment funds managed by professional asset managers. In addition, since the standard market returns such investments would earn are so much higher than what the current pay-as-you-go Social Security system even promises, let alone what it can pay, there is a wide margin for error before the guarantee would come into play. Individuals could earn substandard market returns and still receive higher benefits than what Social Security promises under current law. Consequently, very few people are likely to fall into the safety-net guarantee. This is consistent with the experience with a personal account benefit guarantee in the famous reforms adopted in Chile almost 25 years ago.

Financing the Transition

Of course, any personal account reform plan involves a transition-financing issue, as some of the funds used to pay current benefits under the present system are saved and invested in the personal accounts instead. So additional funds for Social Security must come from somewhere to ensure the continued payment of promised benefits, until the personal accounts start taking over benefit payment responsibilities.

The Ryan-Sununu bill specifies exactly where the funds needed for the transition would come from:

- First, the short-term Social Security surpluses now projected to last until 2018 are devoted to the transition.
- Secondly, the bill contains a national spending limitation measure that would reduce the rate of growth of total federal spending, and devote those savings to the transition as well. The limitation would reduce the rate of growth of federal spending by 1 percentage point per year for eight years. The spending savings for those years are then maintained until all short-term debt issued to fund the transition is paid off in full.

The bill contains a national spending limitation measure that would reduce the rate of growth of total federal spending and devote those savings to the transition as well.

- The third factor would be the increased federal revenues resulting from increased corporate and business investment due to the accounts. The money from the accounts used to buy stocks and bonds goes to the business corporations selling the stocks and bonds. The businesses use those funds to expand their operations, start new business ventures, hire new workers, buy new plant and equipment, etc. The businesses earn returns on these new investments, on which they pay taxes. This results in increased tax revenues for the government, which can be used to pay for part of the transition to personal accounts. This factor is based on the work of Harvard Professor of Economics Martin Feldstein, Chairman of the National Bureau of Economic Research. It was first developed for personal account legislation introduced by former Sen. Phil Gramm in the late 1990s.

- The final factor is that, to the extent needed in any year, excess Social Security trust fund bonds would be redeemed for cash from the federal government, with the funds used to pay full promised Social Security benefits. This is exactly what the trust fund bonds are for—to be redeemed when needed to pay full Social Security benefits. Under the current system, those bonds are going to be redeemed for cash from the federal government anyway after 2018, until the trust fund is exhausted in 2042. The legislation specifies that the cash to finance these redemptions would be obtained by selling new federal bonds to the public that would later be paid off in full out of eventual surpluses generated by the reform.

Under the Ryan-Sununu bill, Social Security achieves permanent and growing surpluses by 2030.

With this transition financing, the official score of the Chief Actuary shows the following:

- Under the Ryan-Sununu bill, Social Security achieves permanent and growing surpluses by 2030. Before that time, an average of about $52 billion (constant 2003 dollars) in surplus Social Security trust fund bonds would be redeemed each year for 25 years, and financed by the sale of an equivalent amount of new federal bonds, ultimately totaling $922 billion in present-value dollars. The amount of such bonds sold each year is shown in Table 1.

- The amounts in Table 1 include bonds sold to cover part of the Social Security deficits under the current system now projected to start in 2018, which will not be fully eliminated under the reform plan until 2030. Table 2 shows the net transition deficit each year that results from the personal accounts alone under the Ryan-Sununu bill, not counting the already-existing Social Security deficits under current law.

- Even with the redemption of surplus trust fund bonds, the Social Security trust fund never falls below $1.34 trillion in today's dollars, or 141 percent of one year's expenditures, with the official standard of solvency being 100 percent. After 2030, the trust fund grows permanently, reaching close to 10 times one year's expenditures by the end of the projection period, or about $6 trillion in today's dollars.

The reform completely eliminates the unfunded liability of Social Security.

- Within 15 years after 2030, the reform produces sufficient surpluses to pay off all the bonds sold to the public during the early years of the reform. So the net impact of the reform on debt held by the public is zero.

- Moreover, in the process of shifting benefit obligations to personal accounts, the reform completely eliminates the unfunded liability of Social Security, currently officially estimated at $11 trillion, which is effectively the largest reduction in government debt in world history.

The transition deficits and debt shown in Tables 1 and 2 are modest given the sweeping magnitude of the reform plan. The amount of transition debt that needs to be issued each year falls to $60

Table 1 THE RYAN-SUNUNU BILL: SOCIAL SECURITY TRUST FUND BONDS REDEEMED TO COVER SOCIAL SECURITY DEFICITS

YEAR	CONSTANT 2003 DOLLARS*	PRESENT VALUE DOLLARS*
2005	144	130
2006	131	115
2007	109	93
2008	89	74
2009	70	56
2010	51	40
2011	30	23
2012	11	8
2013	17	12
2014	24	16
2015	31	20
2016	37	24
2017	43	26
2018	48	28
2019	52	30
2020	56	30
2021	59	31
2022	60	30
2023	57	28
2024	54	25
2025	48	21
2026	40	16
2027	30	11
2028	18	4
2029	2	1
Total:		**922**

*All figures in billions.

Source: "Estimated Financial Effects of the 'Social Security Personal Savings and Prosperity Act of 2004,'" July 19, 2004, Office of the Chief Actuary, Social Security Administration, Table 1e.

Table 2 THE RYAN-SUNUNU BILL: NET ANNUAL TRANSITION DEFICITS

YEAR	NET TRANSITION DEFICIT CONSTANT 2003 DOLLARS*	NET TRANSITION DEFICIT PRESENT VALUE DOLLARS*
2005	144	130
2006	131	115
2007	109	93
2008	89	74
2009	70	56
2010	51	40
2011	30	23
2012	11	8
2013	17	12
2014	24	17
2015	31	21
2016	37	24
2017	43	27
2018	32	20
2019	16	10
Total:		**645**

*All figures in billions.

Source: Calculated from "Estimated Financial Effects of the 'Social Security Personal Savings and Prosperity Act of 2004,'" July 19, 2004, Office of the Chief Actuary, Social Security Administration, Table 1e, and "The 2004 Annual Report of the Board of Trustees of the Federal Old Age and Survivors Insurance and Disability Insurance Trust Funds," March 23, 2004, Table VI.F8.

billion or less after the first five years of the reform. Moreover, that shorter-term debt only involves borrowing back a minor portion of the savings accumulating in the accounts, which, again, grows to $7.8 trillion in today's dollars after the first 15 years, and $16.6 trillion after the first 25 years, when the borrowing stops. Again, within 15 years after that, surpluses generated by the reform completely pay off even that relatively minor effective borrowing from the growing accounts.

In addition, the actual net transition deficits created by the reform itself, not counting the already-existing projected Social Security deficits under current law, are even less, as shown in Table 2. The deficit falls to $51 billion or less in today's dollars after the first five years, and is completely eliminated after 15 years, for a total of $645 billion in present-value dollars over that time.

The legislation creates a separate Social Security Lockbox budget apart from the rest of the budget.

Moreover, again, the legislation creates a separate Social Security Lockbox budget apart from the rest of the budget, so even these transition deficits would not increase the deficit in the regular operating budget for the rest of the federal government. The short-term debt shown in Table 1 also would be separately accounted for in a Social Security Transition Sinking Fund slated to be paid off in full.

Virtually every member of Congress from both parties has supported taking Social Security off budget, putting it into a lockbox where it could no longer be raided for other government spending. The virtually unanimous support for that idea comes from seniors' overwhelming support for such a policy. This legislation finally makes good on this concept.

Separating Social Security and the personal account transition from the rest of the budget is also the most accurate accounting practice, for several reasons. Unlike the deficit in the rest of the budget, the reform plan's net transition deficits are not adding new federal debt and liabilities. The reform plan is instead actually reducing long-term federal liabilities dramatically, ultimately eliminating the unfunded liabilities of Social Security. The shorter-term debt resulting from the reform plan, moreover, is just recognizing debt the government already owes through Social Security's unfunded liability, and even that is fully paid off under the reform plan. In fact, on our current course, we would just effectively start selling these bonds a few more years down the road anyway, to continue financing promised benefits once the current Social Security system starts running annual deficits. But on our current course, there is no plan to later pay off that debt.

The reform plan is actually reducing long-term federal liabilities dramatically.

In addition, again unlike the deficits in the rest of the budget, the reform plan's net transition deficits do not reflect a net drain on national savings. The debt issued to cover those transition deficits only involves borrowing back part of the savings generated through the personal accounts, quite likely producing a large increase in national savings overall.

So it actually would be quite misleading to account for the net transition deficits under the reform in the same way as accounting for deficits in the federal government's general operating budget. The net effect of the reform and its transition deficits on the economy and the federal debt is actually the opposite of the net effect of general federal budget deficits.

Finally, the transition to personal accounts under Ryan-Sununu is a one-time financing project meant to liquidate an enormous federal debt. It is not part of the ongoing operations of the federal government and the long-term liabilities it is racking up. So it would be most accurate to account for the transition separately from those ongoing operations.

Accounting for the transition in this way has the added benefit of protecting the later surpluses of the reform from being gobbled up in the general federal budget process. These later surpluses would be reflected in the separate Social Security Lockbox budget, under a policy of devoting those surpluses to paying off the earlier transition debt, and then to reducing payroll taxes. Any attempt to divert that money to other purposes would be transparent, blatant, and probably politically untenable. Moreover, accounting for the short-term debt in its own separate Social Security Transition Sinking Fund account would provide a scorecard to show whether that debt has, in fact, been paid off.

The federal spending restraint provided for in the bill to help finance the transition is quite modest and achievable.

The federal spending restraint provided for in the bill to help finance the transition is quite modest and achievable. Over the initial eight-year period, it would limit federal spending to grow each year no more than its long-term baseline of the rate of growth of GDP, minus 1 percent. Consequently, during that period, federal spending as a percent of GDP would decline from 20 percent to 18.4 percent. The bill would then allow federal spending to continue to grow at the old baseline rate, keeping spending only 1.6 percent of GDP below that baseline. Once the transition to personal accounts is financed and all short-term debt issued during that transition is paid off, the spending restraint is eliminated.

The spending restraint during the first eight years is actually less than the restraint achieved during the eight years of the Clinton administration, which held federal spending growth to the rate of growth of GDP minus 1.8 percentage points each year. (Of course, the Republican Congress was a primary factor in that achievement.)

Moreover, the restraint during the first eight years is exactly the amount of restraint we will have to achieve if we are going to balance the federal budget while keeping the Bush tax cuts permanent, as shown in a recent study by Larry Hunter.[3] The Bush tax cuts would leave federal revenues over the long run at about 18.4 percent of GDP as well.

Both the Cato Institute and the Heritage Foundation have published extensive material documenting far more in wasteful and counterproductive spending than would be needed to achieve the spending limitation targeted in Ryan-Sununu.[4] Earlier this year, IPI published a study by Steve Moore also proposing far more in desirable spending restraint initiatives.[5] The spending restraint measure in the bill is not limited to domestic discretionary spending, or even all of discretionary spending. All of federal spending outside of Social Security is eligible for restraint to help meet the target. Any and all other entitlement programs can be reformed to meet the target. Corporate welfare can be cut or eliminated. Ditto for long-outdated agriculture subsidies. Even the military budget is not off limits. Unneeded military bases, for example, can be shut down.

Over the long run, the bill's modest spending restraint would allow federal spending to grow by more than 50 percent relative to GDP.

Over the long run, the bill's modest spending restraint would, indeed, allow federal spending to grow by more than 50 percent relative to GDP. That is because after the baby boom generation retires, federal spending will explode relative to GDP, eventually growing from about 20 percent of GDP today to over 30 percent, according to Congressional Budget Office projections. The Ryan-Sununu spending limit would just keep federal spending 1.6 percentage points below this long-term baseline, with the limitation removed completely once the funds are no longer needed to complete the transition.

The spending limitation in Ryan-Sununu, therefore, is just a modest first step. Stricter and permanent spending limits are needed to prevent a historic run-up in federal spending relative to the economy.

The Ryan-Sununu spending limits are enforced by new national spending limitation provisions included in the bill. These provisions reorient the whole federal budget process around the spending limitation, and require a stiff two-thirds majority of both houses to get around it. Budgetary procedures are changed to allow any member of Congress to halt a spending initiative inconsistent with the spending targets.

The bill would powerfully restrain federal spending simply by taking the money off of the table for Congress to spend.

Yes, Congress could still override the spending limits by new legislation in the future. But that is true of any means of financing the transition to personal accounts. Tax increases for the transition can be reversed or offset by future legislation as well. The same is true for measures that attempt to help finance the transition by cutting future promised Social Security benefits.

Moreover, general federal spending restraint enjoys broad public support. Many, many voters today believe federal spending has been growing far too fast, and would think the Ryan-Sununu spending restraints are far too modest for general budget needs. With these public attitudes, the Ryan-Sununu spending restraint could not be easily dismissed.

In addition, the Ryan-Sununu bill would powerfully restrain federal spending simply by taking the money off of the table for Congress to spend. With all of the money going into personal accounts, and the unavoidable mandate to pay all promised Social Security benefits to retirees[6], Congress will be forced to spend less than it would otherwise. As Milton Friedman has long argued, the best way to restrain the federal government's spending is just to reduce what is available for Congress to spend. The Ryan-Sununu bill does that, and therefore is a powerful aid in achieving future spending restraint. Congress cannot run future deficits beyond politically acceptable limits, and there are powerful political forces that work to restrain deficits and reduce the duration of deficits over the long run. These forces would further help to enforce the Ryan-Sununu spending limits.

Finally, the Ryan-Sununu bill changes the political dynamics of federal spending. Basic public choice analysis shows that the beneficiaries of federal spending largesse have a concentrated interest in maintaining and expanding their particular share of the federal spending pie. But the general public doesn't have enough of an interest in any one spending program to provide the resources to overcome the special interests benefiting from it.

The best way to restrain the federal government's spending is just to reduce what is available for Congress to spend.

That fully explains the stubbornness of corporate welfare, for example. XYZ Corporation can have enough direct financial interest in a multibillion-dollar federal subsidy program to hire legions of lobbyists and publicists to promote its cause. But individual members of the general public do not have enough of a financial stake in that one program to provide the resources to counter the predatory corporate welfare boondoggle.

This is why federal spending restraint ultimately can only be achieved by a general federal spending restraint as in Ryan-Sununu. Individual members of the public do have enough of a stake in such a general restraint to get involved in providing the necessary political support to adopt and enforce it. Ryan-Sununu adds to this by tying the spending restraint to a very popular large personal account option for Social Security. That greatly increases the likelihood that such a restraint can be adopted and be maintained over time. Indeed, under the bill workers would enjoy every dollar of spending restraint, with that money effectively going into their direct personal accounts instead.

The bottom line is that Congress can avoid running up debt to finance the transition under Ryan-Sununu simply by following the reasonable and moderate spending restraint provided in the bill. If it chooses more spending and debt instead, that would result only because Congress decided that was more desirable.

Under the bill, workers would enjoy every dollar of spending restraint, with that money effectively going into their direct personal accounts.

The third factor in the Ryan-Sununu transition financing, the increased tax revenues resulting from investment of the personal account funds, is again based on the work of Harvard Professor of Economics Martin Feldstein, Chairman of the National Bureau of Economic Research. The methodology for scoring this impact was first developed by the Chief Actuary of Social Security in consultation with Feldstein for legislation introduced in the late 1990s by former Sen. Phil Gramm. That same methodology was used for the scoring of the Ryan-Sununu bill.

This revenue feedback is available for the scoring of any personal account reform plan, because it flows automatically from the operation of the personal accounts. Failing to include it would reflect an incomplete understanding of the economics of personal accounts.

Moreover, this revenue feedback as scored takes into account just one of the positive economic effects of the reform, which the work of Feldstein and others shows would be far more extensive.[7] The large personal accounts in the Ryan-Sununu plan are effectively an immediate enormous reduction in payroll taxes on labor of 6.4 percentage points on average. That is because the money would be going into personal accounts directly owned and controlled by each worker, like a 401(k) plan, and not to the government as a tax to be redistributed to others. The legislation also provides for further payroll tax relief in later years. This tax relief would provide another major boost to the economy and labor market efficiency, which would result in higher tax revenues.

Increased savings and investment through the accounts also would lead to higher wages, thanks to the productivity increases that result from greater capital. Higher wages also would produce higher tax revenues. Greater retirement benefits produced by the personal accounts also would generate higher tax revenues, as those benefits are either spent or saved and invested again.

The present value of the combined economic growth effects of personal account reforms would be $10 to $20 trillion.

Feldstein estimates that the present value of the combined economic growth effects of personal account reforms would be $10 to $20 trillion.[8] So many conservative assumptions went into that calculation that the ultimate effect probably would be substantially higher. But, in any event, these full economic growth effects of personal accounts will produce substantially more revenues than scored by the Chief Actuary for the Ryan-Sununu bill.

Indeed, Hunter calculates that an increase in the economic growth rate of just one half of 1 percent due to these personal accounts—still leaving the long-term economic growth rate assumed by the Chief Actuary in his score 40 percent less than the long-term growth rate of the economy over the last 50 years—would produce a higher revenue feedback than reflected in the Ryan-Sununu score. If the personal accounts just raised economic growth to the long-term growth rate of the last 50 years, the revenue feedback would dwarf the feedback in the Chief Actuary's score of Ryan-Sununu.

With the large accounts in Ryan-Sununu, we would be shifting close to 20 percent of the whole federal government from a redistribution system to a savings and investment system, with large reductions in taxes to boot. Such an enormous, dramatic change in federal economic policy cannot be plausibly evaluated without taking at least some of these economic growth effects into account.

We would be shifting close to 20 percent of the whole federal government from a redistribution system to a savings and investment system.

Finally, the transition financing provided by this revenue feedback and the spending restraint involves $7.1 trillion (present value dollars) in general revenues provided to Social Security over the life of the transition. Some erroneously argue that the amount of general revenues used in a reform plan is the measure of how much a reform plan costs. In another IPI study, this is shown to be fallacious.[9]

About 54 percent of the general revenues used for the Ryan-Sununu plan come from the increased revenue feedback. These general revenues were generated by the reform plan itself. They would not exist without the reform. Consequently, they cannot logically be considered part of the net cost of the reform plan. Quite to the contrary, these additional revenues are a benefit of the reform plan, used to offset, and hence reduce, the net transition-financing burden. This leaves the net general revenues used for Ryan-Sununu at $3.8 trillion.

Moreover, to the extent the spending restraint in Ryan-Sununu produces reductions in wasteful or counterproductive federal spending, those reductions also would not represent a cost. Again, quite to the contrary, those reductions in fact would be another benefit of the reform plan, used to offset and hence reduce the net transition-financing burden.

Conclusion

The Ryan-Sununu bill would produce dramatic, historic, breakthrough gains in personal prosperity for working people.

The Ryan-Sununu bill would produce dramatic, historic, breakthrough gains in personal prosperity for working people, including the following:

- The long-term Social Security financing crisis would be completely eliminated, without cutting benefits or raising taxes. This includes the disability and survivors' portion of the program as well as the retirement portion, because the long-term surpluses resulting from the personal accounts for retirement benefits are large enough to eliminate the deficits for disability and survivors' benefits as well.

- Indeed, because capital market returns are so much higher than the returns that can be paid by the current non-invested, merely redistributive Social Security framework, workers would receive through the large accounts in Ryan-Sununu much higher benefits than Social Security even promises today, let alone what it actually can pay. At standard market investment returns, the personal accounts would pay roughly two-thirds to 100 percent more in benefits than Social Security now promises workers in the future.

- In addition, instead of increasing the payroll tax from 12.4 percent today to close to 20 percent, as ultimately would be necessary to pay all promised benefits under current law, Ryan-Sununu would ultimately reduce the payroll tax to 4 percent. The bill includes an automatic payroll tax cut trigger to achieve this goal. **This would amount to the largest reduction in taxes in world history.**

- Moreover, in the process of this reform, the current unfunded liability of Social Security would be eliminated. That unfunded liability is estimated at about $11 trillion, about three times the amount of federal debt currently held by the public. **This would amount to the largest reduction in government debt in world history.**

> ***Ryan-Sununu would ultimately reduce the payroll tax to 4 percent.***

- By shifting Social Security retirement benefits to be paid through personal accounts, and financing part of the transition through federal spending restraint, the Ryan-Sununu bill ultimately would reduce federal spending as a percent of GDP by about 6.5 percentage points. The bill gains control over runaway federal spending through a comprehensive national spending limitation measure.

- Through the Ryan-Sununu personal accounts, for the first time workers at all income levels would be accumulating substantial personal savings and investment. Indeed, after just the first 15 years of reform, the Chief Actuary estimates that personal accounts would accumulate to $7.8 trillion in today's dollars. This would dramatically broaden the ownership of wealth and greatly reduce the concentration of wealth.

- The personal account reform would produce major long-term increases in economic growth. This would translate into more jobs and higher wages for working people.

The tradeoff for this enormous, historic benefit is the transition-financing burden, which is financed under Ryan-Sununu by:

1. devoting the short-term Social Security surpluses to the transition;

2. devoting to the transition the funds obtained by restraining the rate of growth of federal spending by 1 percentage point a year for each of eight years, and maintaining those savings until the transition financing is completed;

3. devoting to the transition the increased revenues resulting from the investment of the personal account funds at the corporate and business level;

4. redeeming—to the extent the first three are not sufficient in any one year—excess Social Security trust fund bonds financed by selling new federal bonds to the public, with those bonds to be paid off out of the later surpluses of the reform.

> ***The personal account reform would produce major long-term growth. This would translate into more jobs and higher wages for working people.***

Trying to distort this tradeoff with scary, out-of-context 75-year summary numbers in 2003 dollars, or by emphasizing irrelevant comparisons based on general revenue transfers, does not advance understanding of personal account reform, and only delays the ultimate success of such reform. Such numbers games do not change the fact that the above summary discussion is an accurate presentation of the tradeoffs involved in the reform as proposed. The enormous benefits discussed above seem quite easily worth the above transition-financing burden, and the public is quite likely to see it as so.

The Ryan-Sununu reform plan truly modernizes and expands the Social Security framework, bringing in real personal savings and investment for a new financial foundation for the program. Such reform really just makes good on the original promise of Social Security, when everyone thought they were really going to have individual accounts with the government that would be saved and invested. Moreover, the guarantee of current-law benefits in Ryan-Sununu keeps the current social safety net in place. The bill also maintains a social framework to make personal account investing for even unsophisticated investors.

What it all adds up to is a historic breakthrough in the personal prosperity of working people.

With this modernization, Social Security's financial difficulties will be ended for good, and workers will be able to gain sharply higher benefits, much lower taxes, and the accumulation of substantial personal wealth for their families. What it all adds up to is a historic breakthrough in the personal prosperity of working people.

Endnotes

1. "Estimated Financial Effects of the 'Social Security Personal Savings and Prosperity Act of 2004,'" July 19, 2004, Office of the Chief Actuary, Social Security Administration.
2. Peter Ferrara, "A Progressive Proposal for Social Security Personal Accounts," Institute for Policy Innovation, Policy Report 176, June 2003, pp. 13-15.
3. Larry Hunter, "Reducing Government Consumption, Increasing Personal Wealth: Limiting Federal Spending Growth Through Large Personal Retirement Accounts," IPI Policy Report 183, July 14, 2004. The study assumed as well that the Alternative Minimum Tax is reformed so it applies only to the highest-income taxpayers as originally intended, and not to the middle class.
4. See, e.g., Chris Edwards, "Downsizing the Federal Government," Cato Policy Analysis No. 515, June 2, 2004.
5. Stephen Moore, "Putting Taxpayers First: A Federal Budget Plan to Benefit the Next Generation of American Taxpayers," IPI Policy Report 174, February 17, 2004.
6. The Ryan-Sununu bill ensures that Social Security will be taken care of in any event and all promised benefits to current retirees would continue to be paid. The bill provides that the federal government would transfer general revenues to Social Security each year equal to the amount of annual spending restraint provided in the bill, regardless of what Congress actually does in regard to spending. It is then up to Congress to implement the spending restraint, or find the money elsewhere, or affirmatively choose to run larger general deficits.
7. Peter Ferrara and Michael Tanner, *A New Deal for Social Security*, Washington, D.C.: Cato Institute, 1998, Chapter 6.
8. Martin Feldstein, "The Missing Piece in Policy Analysis: Social Security Reform," *American Economic Review*, Vol. 86, p.1 (May 1996).
9. Peter Ferrara, "The Cost of Personal Retirement Accounts," IPI Issue Brief, Nov. 10, 2004.

About the Author

Peter Ferrara is a Senior Research Fellow with the Institute for Policy Innovation and is Director of the International Center for Law and Economics and President of the Virginia Club for Growth. He served as a senior staff member in the White House Office of Policy Development under President Reagan and as Associate Deputy Attorney General of the United States under the first President Bush. He is a graduate of Harvard College and Harvard Law School, and has practiced law with firms on Wall Street and in Washington, DC. He wrote the first book for the Cato Institute providing a comprehensive intellectual foundation for a personal account option for Social Security, *Social Security: The Inherent Contradiction* (1980), and has continued to write on that concept in further books, studies and articles for IPI, Cato, the Heritage Foundation, the National Center for Policy Analysis, the Family Research Council, the U.S. Chamber of Commerce, and a wide range of other institutions and publications.

About the IPI Center for Economic Growth

Few public policy issues are as critical as sustained economic growth. Through the IPI Center for Economic Growth, the Institute for Policy Innovation pursues policy changes designed to increase levels of stable, predictable economic growth. The Center believes that critical lessons were learned during the 20th Century (particularly during the 1980s and 1990s) about how private property, government regulation, tax policy and monetary policy contribute to or undermine economic growth, and seeks to apply those lessons to 21st Century policy issues. The Center advocates protection of private property, deregulation, competition, innovation, entrepreneurship, stable currency, and low tax rates as means to achieving sustained high levels of economic growth, and denies that there is any public policy downside to high levels of economic growth.

About the Institute for Policy Innovation

The Institute for Policy Innovation (IPI) is a non-profit, non-partisan educational organization founded in 1987. IPI's purposes are to conduct research, aid development, and widely promote innovative and non-partisan solutions to today's public policy problems. IPI is a public foundation, and is supported wholly by contributions from individuals, businesses, and other non-profit foundations. IPI neither solicits nor accepts contributions from any government agency.

IPI's focus is on developing new approaches to governing that harness the strengths of individual choice, limited government, and free markets. IPI emphasizes getting its studies into the hands of the press and policy makers so that the ideas they contain can be applied to the challenges facing us today.

Institute For Policy Innovation

IPI

1660 South Stemmons Frwy.
Suite 475
Lewisville, TX 75067
(972) 874-5139 [voice]
(972) 874-5144 [fax]
Email: ipi@ipi.org
Website: www.ipi.org