It is time to propose a change in the way we manage the Social Security Trust Fund reserve, and in this chapter I propose one viable method of approaching the system's financing problems. My plan, although not a complete solution to the larger, long-term financial ills of Social Security, would improve the long-term health of Social Security by converting the Trust Fund reserve from a pile of government IOUs into real savings controlled by individuals. Indeed, I have always been careful to note the specific focus of my plan—the management of the Trust Fund reserve. Clearly, Social Security's larger problems will have to be dealt with at some time through more comprehensive changes in order for the future of this vital and successful program to be guaranteed.

The purpose of the legislation, known as the Porter Plan, is twofold. First and foremost, it would take from the government the reserve Social Security payroll tax revenues, those not needed to pay current benefits and which are nominally being collected to help pay the baby boom generation's Social Security benefits. These are currently being spent to finance present-day deficits. Under the Porter Plan, the reserves would instead be refunded into mandatory, individually held accounts treated much like IRAs. This change in legislation would guarantee the availability of these funds for the baby boom generation's retirement, something I believe the current policy makes highly unlikely if not altogether impossible, as will be explained in greater detail below.

Second, by changing the management of the reserve so as to remove it from the federal government's hands, the government would be forced to raise more deficit capital in the private markets and the true size of the annual federal budget deficit would be revealed in sharp relief. I am hopeful that this change would put additional pressure on Congress and
the President to cut spending further in order to stem the current, much-larger-than-understood river of red ink flowing from Washington.

The 1983 Social Security amendments increased Social Security payroll taxes in order to create a reserve within the Social Security Trust Fund intended to cover the shortfall between the Social Security system's tax and interest income and its benefit outgo which will occur when the baby boom generation retires and draws Social Security benefits. At that time, there will be approximately 25 million more retirees on the Social Security benefit rolls than there are today without a proportionate increase in taxpaying workers. The reserve is thus designed to protect future workers from sharp increases in payroll taxes which would occur if Social Security were operated under pay-as-you-go financing. While those tax increases could be mitigated through significant cuts in Social Security benefits, I doubt the likelihood of such cuts given the apprehension with which most Members of Congress approach the issue.

In light of the fiscal impact of the baby boomers and the need to protect future workers from higher taxes, the Trust Fund reserve is a wise and valuable management tool. Unfortunately, current law governing the investment and management of the reserve is fueling congressional profligacy and will eventually undermine the Social Security system.

Each year, the Social Security system receives various tax revenues. These funds are used first to pay the benefits of current beneficiaries. Surplus funds remaining after these payments (the annual reserves) are by law invested in special issue, interest-bearing Treasury bonds. Surpluses "invested" in these bonds are credited on government ledgers to the Social Security Trust Fund, and the United States Treasury receives the cash. The Trust Fund surplus, then, is simply a collection of government IOUs.

This transfer of reserve cash to the Treasury creates serious problems since this cash is, from the standpoint of the Treasury, indistinguishable from any other revenues paid to the federal government. Because current law does not require reserve monies to be set aside or otherwise saved separately from other government funds, and because the federal government continues to run annual budget deficits, the reserve funds are used to finance present-day general operations of the government. In other words, the Social Security Trust Fund surplus finances part of today's deficit spending. The Congressional Budget Office (CBO) confirmed this analysis when it noted that "as long as the trust fund operates with an annual surplus, the policy of investing in special issues means that the government does not have to borrow as much from the public to finance the deficit in the rest of the government's accounts" (CBO 1994:1).

If left unchecked, current law governing the Trust Fund reserve will
cause a serious fiscal crisis when the baby boomers retire. At that time, the Social Security system will begin redeeming its Treasury bonds in order to pay retirement benefits. When these transactions take place, the federal government will have to produce literally hundreds of billions of dollars in each of several years to pay back the bonds held by Social Security. Since the money obtained from issuing the bonds will have already been spent on today's deficits and will not be backed by any real assets, the government at that time will have to obtain it by either raising taxes or by sharply cutting spending on other federal programs. If these options are unpalatable, the government may instead choose to renege on its promise to the baby boomers and greatly reduce their Social Security benefits. Each of these options is likely, at the very least, to be economically disruptive and politically excruciating.

Because the excess money is simply making it easier for Congress to continue deficit spending, I have reintroduced legislation which would reduce Social Security payroll taxes by the amount not needed for current beneficiaries, namely, about 1 percent. Both employers and employees would now be required to contribute .50 percent into mandatory Individual Social Security Retirement Accounts, or ISSRAs. These IRA-like accounts would be held in private-sector entities and would accrue tax-free interest over the working lifetime of the individual. Individual recipients would own the accounts and would direct bonded ISSRA trustees—banks, insurance companies, brokers, or other money managers—in investing ISSRA moneys. While the Porter Plan contains no specific guidelines, I conceive of ISSRA account investments as being limited by law to safe, non-speculative investments such as time deposits, government obligations, AAA corporate bonds, and certain mutual funds that would allow money to be saved and invested and grow as a nest egg for the future. The trustees would be required by law to abide by the investment guidelines and would only be able to pay the money to purchase an annuity when the owner reaches retirement age. The ISSRA system would be phased in gradually and would take roughly forty years to become fully vested. As mentioned above, my legislation affects only the management of the Trust Fund reserves. It does not change current law governing replacement rates, cost-of-living adjustments, or scheduled changes in the Social Security retirement age.

Under the Porter Plan, an individual's Social Security benefits would consist of two parts: an annuity purchased with the person's ISSRA funds and an adjusted payment from the Social Security Trust Fund itself. Payments from the Trust Fund would be adjusted to ensure that benefits would remain at the same level as they are today under current law, not increased by the amount of an individual's ISSRA payment. In a recent Social Security subcommittee hearing, the CBO criticized the Porter
Plan because it did not contain an offset mechanism which would ensure Social Security’s progressive benefit structure. In the revised bill, I worked with the General Accounting Office of Congress (GAO) to implement a benefit adjustment that would maintain the progressivity under a mixed private/public Social Security system. GAO’s analysis showed that an ISSRA system could actually increase benefits slightly given moderately good economic conditions. Interestingly, the analysis also showed that a 2 percent diversion into ISSRAs conducted during the period when Social Security was accumulating a reserve would increase benefits more than would a 1 percent diversion—even with an appropriate benefit adjustment (GAO 1990, 1994). CBO might wish to review GAO’s work in this area, especially since CBO’s hearing report largely discounts the notion that partial privatization would improve benefits.

Thus the Porter Plan would take from Congress the reserve funds it is supposed to save but which it instead spends on present-day deficit spending. This change would help protect baby boomers from cuts in Social Security benefits and protect future workers from huge tax increases. It would prevent the need for enormous future cuts in government programs to finance redemption of Social Security’s special issue bonds. At the very least, establishment of an ISSRA system would give baby boomers the moneys they have in their ISSRAS to use for retirement. Under the current system, they may well end up receiving little if any money from Social Security given the demographic, fiscal, and Trust Fund management trends discussed above. Finally, it would force the federal government to borrow more from public markets to finance the deficit and thereby make the enormity of our fiscal problems far more readily apparent to the general public than it is today.

The Porter Plan has several other positive attributes. First, it would make every American worker an investor in our economy. Every worker in America who paid Social Security taxes would have an ISSRA and would thereby have a tangible stake in the success of our economy. Second, Americans who have not otherwise saved during their lifetimes would have savings that would be theirs, that they would manage, and which would grow and be available as part of their retirement. Third, it would give all workers an asset to pass on to their families. Today, if one dies prior to becoming eligible for Social Security old age benefits, those benefits are gone except for survivors’ benefits in some cases. However, under my proposal, someone who dies prior to retirement age would pass on accumulated ISSRA funds as part of his or her estate. Fourth, my proposal would put US $3 trillion, in 1990 dollars, or at least a very substantial part of that, into private-sector investments. This infusion of capital, coupled with an expected drop in the deficit because Congress would not have the reserve to spend, should help drive down interest rates and
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speed future economic growth. Finally, my plan would create the basis of a completely portable private pension system. In other words, if I were a worker directing part of my Social Security into an ISSRA with every paycheck, I would go to my employer and say, “Forget the pension plan. I want my share paid into my ISSRA account.” Years later when I am about to retire, I would not have to worry about whether the pension plan of the company had been mismanaged or stolen or gone broke. I would have the money in my own hands. I would have invested it and I would know that it is available for my retirement.

I realize that one criticism my colleagues might have of the ISSRA plan as described here is that the investment guidelines allow people to invest in Treasury bills, something I am trying on one level to prevent the government from doing. My answer is that allowing such investments leaves the choice up to the individual rather than having the government do so on autopilot, as under current law. I would note that a greater proportion of federal debt instruments would be held by American citizens, not foreign creditors.

I believe that most of us in Congress and, indeed, many members of the public understand the fact that the Trust Fund reserve is not real, that it has been spent, continues to be spent, and exists only on paper. Few if any of us really believe Social Security will have the money it needs to work as it should when the baby boomers retire and the system’s “special issues” come due. We must soberly face this issue as an institution and change law accordingly. I offer the Porter Plan as a positive way to do so.

References

