Common Ground On Social Security

By Martin Feldstein

As the debate over Social Security heats up, many are stressing differences between the proposals made by Congressional Republicans and those outlined by President Clinton in his State of the Union address in January. But those differences are not as great as they may seem — and there is no reason that the White House can’t find enough common ground with Congress to work out a plan that is politically palatable to both sides.

The distinguishing feature of the various Republican approaches is their use of personal retirement accounts. These would be set up for each taxpayer and would be combined with the existing system in a way that guarantees that everyone receives at least as much as is currently promised under the current Social Security rules.

Repeated attempts to characterize the difference between the Republican approach and the President’s plan as a major ideological clash are fundamentally wrong, based on either a misunderstanding of what the Republicans propose or a desire to prevent compromise in order to use Social Security as an election issue in 2000. Individual accounts do not mean “privatizing” Social Security. The Government would set up the accounts, regulate the investments and guarantee the benefits.

Both sides acknowledge that the current tax-financed Social Security program is in serious trouble. The benefits specified in law will exceed Social Security tax receipts within 15 years and the trust fund will be exhausted by about 2034, according to the Government report issued yesterday.

Both sides also agree that Social Security is responsible for maintaining the benefits of current and future retirees. The building blocks used in both approaches — saving the budget surplus and investing in equities — are also similar. And the Republicans have tailored many of the details of their plans in ways that should attract bipartisan support.

There are, in fact, several somewhat different Republican proposals. But a typical one would work like this: All those who are employed or self-employed would select a fund manager — probably a bank or mutual fund — along with specific mutual funds to invest in. (If the investor didn’t select a fund manager and mix of investments, the Government would choose one from an approved list.)

Each year, the Government would deposit about 2 percent of the employee’s previous year's earnings (up to the Social Security maximum, which now stands at $72,600) into the individual’s account. The deposits would be paid out of the budget surpluses that have been projected. Employees and employers would continue to pay the full Social Security payroll tax just as they do now.

At retirement, the accumulated investments would be converted into an annuity based on the investor's stock and bond mutual funds. Three-fourths of each annuity payment would be used to help finance the individual’s guaranteed Social Security benefit, and the remaining one-fourth would be a bonus for the retiree.

A major feature of this plan is that all beneficiaries, retirees, dependents and survivors would receive their full benefits, no matter how their stock investments performed. Benefits could exceed those promised under Social Security but could not be worse. The returns earned in the personal retirement accounts would almost certainly be enough to pay those benefits. But if the market underperforms, future taxpayers would fill the gap, just as they would under President Clinton’s plan.

The individual accounts would also ensure that the budget surpluses set aside for Social Security would actually increase national saving. This has not been the case with the Social Security surpluses that have built up since the early 1980's. Although those sums went into the trust fund, the Government ran deficits elsewhere in the budget that reduced national saving.

The President's goal of raising national saving would therefore be served more effectively through the discipline of individual accounts than by trying to pay down the national debt.

By increasing national saving and investment, personal retirement accounts would raise both national income and tax revenue. And that additional revenue could be used to finance the Government's deposits to personal retirement accounts after the currently projected budget surpluses are ended.

My calculations show that personal retirement account annuities financed with about 2 percent of covered earnings are enough to keep Social Security solvent for at least the next 75 years. This would make unnecessary the President's proposal to issue new Government bonds to the Trust Fund in order to guarantee benefits between 2038 and 2055, thereby avoiding a fight over the implicit commitment to future tax increases or budget deficits.

It's significant that Mr. Clinton's plan would also use investment in the market. But rather than limiting investment to individually controlled accounts, the White House plan would have the Government itself place some portion of the Social Security trust fund in equities. This raises the danger of Government meddling in the equity market and in the affairs of individual companies.

The President has also called for Government subsidies to help individuals set up retirement accounts invested in stocks and bonds, but that would be kept outside the Social Security framework. What possible reason, other than partisan fears about "tinkering with the system," is there for keeping the accounts separate?

In his State of the Union address, Mr. Clinton called for bipartisan negotiations on a new Social Security plan. His own proposal and the most viable Republican plans have enough in common to give such negotiations a good chance of succeeding.

Clinton and Congress agree on investing in the stock market.

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