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ECONOMIC VIEWPOINT
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Social Security: Pick The Best Part Of Every Plan

One idea: A guaranteed minimum benefit for low-income seniors

The debate over Social Security reform is framed in a way that pits concerns about a "crisis" against claims that the current system merely needs some minor fixes. That's a pity because the real question should be how to design a Social Security system that builds on the program's success in lifting seniors out of poverty while helping all Americans prepare for retirement.

If we were starting from scratch, we would likely design a Social Security system that builds individual savings for retirement. Making such saving compulsory, as in the current system, would avoid the cost of supporting individuals other-wise unprepared for retirement. Incorporating a minimum benefit would allow the system to be progressive. But we aren't starting from scratch. Social Security's fiscal problems are real. So a better program should emphasize three pieces:

CREATE PERSONAL ACCOUNTS. A pre-funded Social Security system generates real savings to provide future retirement benefits. As with 401(k) pension plans, funds can be placed in personal accounts. Social Security personal accounts also re-duce the political risk of diverting Social Security money to fund other government spending. Such accounts offer an op-portunity to build wealth and a bequeathable asset. An account balanced between broad stock and bond index funds could increase resources for retirement with modest risk and costs.

Some Wall Street analysts worry that diverting payroll taxes to fund personal accounts will create large "transition costs" of Social Security reform because the continued payment of current benefits necessitates additional borrowing. Once Social Security's long-term financial footing is restored, avoiding transition costs associated with personal accounts is straight-forward. Future traditional benefits would be reduced so that the present value of the combination of personal account contributions and traditional benefits remains unaffected.

STRENGTHEN BENEFITS FOR LOW-INCOME WORKERS. Social Security's central role is to be a safety net for seniors. And safety-net benefits to keep seniors out of poverty should be a vital part of a 21st century Social Security system. One way to accomplish that would be to guarantee a minimum benefit. A second alternative would be to set a more generous initial benefit for low-lifetime-income workers than for middle- and high-lifetime-income workers. Finally, contributions of low-income individuals to personal accounts could be matched in some proportion with public contributions to bolster future income in retirement.

RESTORE LONG-TERM FINANCIAL STABILITY. The present value of Social Security's unfunded liabilities is in the trillions of dollars. And faster economic growth alone will not eliminate the shortfall. This is because when workers' initial Social Security benefits are set at the time of retirement, their average earnings over their careers are adjusted higher by average wage gains over their careers. This "wage indexing" locks in productivity gains over a worker's career, capturing the benefits of more rapid economic growth in higher benefits.

One way out of the fiscal trap is to slow the rate of growth of Social Security benefits. "Price indexing" would adjust new retirees' career earnings by the rise in prices over their careers. Over a long horizon the shift eliminates Social Security's financial shortfall and then some. These savings could be used to raise the benefits of low-income workers in retirement.

Of course we could choose to solve the Social Security funding problem with higher payroll taxes and/or higher income taxes. But such hikes discourage work and entrepreneurship. These costs of tax increases hurt economic growth and our ability to fund Social Security, Medicare, and all of our public obligations.

The pieces can be combined in different ways. We can create personal accounts, strengthen benefits for low-income workers, and stabilize Social Security's financial footing without requiring strict adherence to the details of any one proposal. Personal accounts could be added on to or carved out of traditional Social Security benefits depending on the size of the actuarial adjustment we make to Social Security benefits. Enhanced support for low-income workers could come through supplements to personal accounts or traditional benefits.

Restoring Social Security's financial health is important. But equally vital is the chance to boost the system's ability to meet the retirement needs of millions of Americans. Failing the first challenge would be perilous, but ignoring the second would be a bigger insult to what Social Security has already achieved.