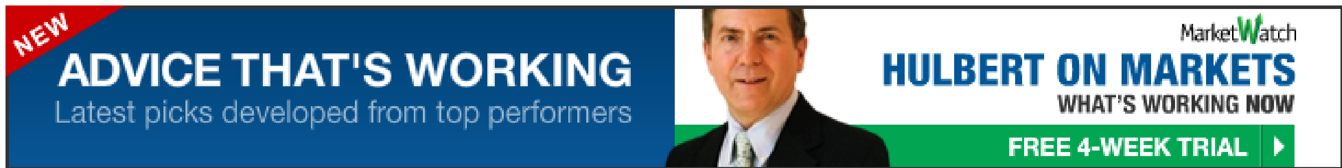

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Private Social Security Accounts: Still a Good Idea

A couple who worked from 1965 to 2009 would have beat the government payout by 75%.

By WILLIAM G. SHIPMAN AND PETER FERRARA

As Democrats and Republicans jockey to set Congress's agenda for after the midterm elections, President Obama has already dismissed one reform that would improve Americans' financial standing: allowing workers to save and invest some of their Social Security taxes in personal accounts.

That's an "ill-conceived" proposal, Mr. Obama said in August, because it means "tying your benefits to the whims of Wall Street traders and the ups and downs of the stock market." The financial crisis, he said, should have put this idea to rest "once and for all."

Missing from the president's statements is any acknowledgment that, to date, all proposals to create personal accounts have provided workers with the option to invest for retirement or to stay with Social Security. Any worker could choose to reject the option. So, contrary to the president's assertion, creating personal accounts wouldn't suddenly empower those who "would gamble your Social Security on Wall Street."

In addition, no proposal has required workers to invest personal account funds in Wall Street stocks, as opposed to other investments such as corporate or government bonds, bond mutual funds or indexes, or certificates of deposit.

Suppose a senior citizen—let's call him "Joe the Plumber"—who retired at the end of 2009, at age 66, had been able to set up a personal account when he entered the work force in 1965, at the age of 21. Suppose that, paying into his personal account what he and his employer would have paid into Social Security, Joe was foolish enough to invest his entire portfolio in the stock market for all 45 years of his working career. How would he have fared in the recent financial crisis?

While working, Joe had earned the average income for full-time male workers. His wife Mary, also age 66, had earned the average income for full-time female workers. They invested together in an indexed portfolio of 90% large-cap stocks and 10% small-cap stocks, which earned the returns reported each year since 1965.

By the time of their retirement in 2009, Joe and Mary would have accumulated account funds, after administrative costs, of $855,175. Indeed, they would have been millionaires a few years earlier, but the financial crisis lost them 37% in 2008. They were unfortunate to retire just one year after the worst 10-year stock market performance since 1926. Yet their account, having earned a 6.75% return annually from 1965 to 2009, would still pay them about 75% more than Social Security would have.

What's more, this model assumes that in retirement Joe and Mary switch to a lower-risk, conservative portfolio that averages a return of just 3%. Of course for young workers today, Social Security promises even lower returns of only

1.5% or less, given the actuarial value of all promised benefits. For many, the promised returns are zero or negative. And if Congress raises taxes or cuts benefits in order to close financial gaps—as everyone who rejects personal accounts effectively advocates—the eventual returns for young workers will be even lower.

It is a mathematical fact that the least expensive way to provide for an almost certain future liability is to save and invest in capital markets prior to the onset of the liability. That's why state and local pension funds, corporate pension plans, federal employee retirement plans and Chile's successful Social Security personal accounts (since copied by other countries) do so. It is sound practice.

And it's why Mr. Obama is wrong to assert that personal Social Security accounts are "ill-conceived," and why each of us should have the liberty to opt into one.

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