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WEEK IN REVIEW DESK

The Nation; Do-It-Yourself Social Security: Many Blanks Left to Fill In

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SUPPOSE the government, as President Bush has proposed, were to allow workers to divert part of their Social Security taxes into individual investment accounts. What would that really mean?

Would participation be voluntary or mandatory? How much money could people expect to have accumulated when they retire? What would they be allowed to invest in?

Would workers get their accounts in a lump sum when they retired, or would they be required to buy a financial instrument that would spread out payments over the rest of their lives? Would participants be allowed to withdraw any money before they retire? Could they leave their accounts to their heirs when they died? What would happen to people who reach retirement age in a bear market?

Leave aside for now the big question of how to raise the hundreds of billions, or more likely, trillions of dollars to pay benefits to current retirees while money is being diverted to personal accounts. The latest word is that the president wants to borrow the money; Congress may balk.

But even if Mr. Bush persuades lawmakers to adopt that course, many other thorny issues will still need to be resolved. Some of them could be deal breakers next year, when Congress begins to consider the proposal, the biggest potential change in Social Security since its inception in 1935.

SIZE OF ACCOUNTS -- The individual accounts are not likely to be nearly as large as some proponents have imagined.

Workers and their employers are each now assessed a payroll tax of 6.2 percent on wages up to \$87,900 a year. The best guess is that up to 2 percentage points of that tax would be allowed to go into the accounts. For someone earning \$35,000 annually, that comes to \$700 a year.

Assume that this person started working at 21 and saw his pay rise so that he was always a medium earner. Figure that half the money is invested in stocks (with an average annual yield of 6.5 percent), 30 percent in corporate bonds (a 3.5 percent yield) and 20 percent in Treasury bonds (3 percent), and then deduct 0.3 percent a year for administrative fees. At 65, after 44 years working, the account would contain only about \$100,000 in 2004 dollars. A low-wage earner would have less than that; even someone investing \$1,000 a year -- the maximum allowed under many proposals -- would only accumulate about \$140,000 by retirement.

TYPES OF INVESTMENTS -- Almost all advocates of private accounts would strictly limit the investment choices to a specified low-risk mix of stock-index funds and bonds. Because Republicans are in control, it's a safe bet that the accounts would be administered by selected private managers and not by the government. But even so, it may not be possible to keep politicians' hands off. It is easy to imagine someone in Congress proposing that index funds be ineligible for the program if they hold the stocks of, say, tobacco companies or the makers of morning-after pills.

VOLUNTARY OR MANDATORY -- During the campaign, Mr. Bush insisted that the accounts would be voluntary and that workers would be free to leave all their tax money in the traditional Social Security system and get full benefits at retirement.

That raises questions: Would workers have to decide irrevocably whether to participate when they first entered the work force at, say, 18? Or would they be allowed to switch in and out? If so, it might make sense for most workers to invest in the private accounts when young, and then switch entirely to Social Security closer to retirement age. How would retirement benefits be adjusted to account for the switches?

WITHDRAWALS -- To protect old people from insolvency, most advocates of private accounts say the workers who own them should not have any access to the money until retirement. But there is bound to be pressure to let people withdraw the money or borrow against it for college tuition, for instance, or emergency expenses. And it may seem callous to make workers leave their accounts untapped if they become terminally ill and will never get to use the money in retirement.

ANNUITIES -- The view of nearly all supporters of private investment accounts is that when people retire, they should be required to put all or most of the money accumulated in their account into a lifetime annuity -- a financial instrument that would pay a fixed monthly income until they die. Then there would be no risk of a retiree outliving her money and then having to get by on her reduced Social Security benefits.

John Wesley, an annuities specialist at TIAA-CREF, the giant pension fund, calculates that at today's interest rates, a \$100,000 account converted by a 65-year-old into a lifetime annuity would pay about \$500 a month, or \$6,000 a year, as long as the retiree or her spouse lived. It would take almost 17 years of payouts just for the couple to get their original money back.

Competition for the flood in business from retirees might lead investment companies to make annuities more attractive -- perhaps by offering higher monthly payments in the first years, or by allowing the retiree to renegotiate the terms if rates rose.

Two more problems: Unlike Social Security benefits, lifetime annuity payments are not adjusted for inflation, so people who live to an old age might find the value of their checks whittled away by higher prices. And typically, the annuity dies when the retiree does, negating the argument that private accounts would create wealth that could be bequeathed to heirs.

MARKET FLUCTUATIONS -- One conundrum may be too basic to resolve. The value of workers' accounts would vary significantly depending on whether the stock market and interest rates happened to be up or down when they retired. Gary Burtless, an economist at the Brookings Institution, published a paper last year showing how a worker who had invested half in stocks and half in bonds and retired in 2000 would have about 50 percent more money in his account than someone who followed the same course but retired in 2003.

Michael Tanner, an expert on Social Security at the Cato Institute, suggested that people retiring in a bear market might put off converting their accounts into annuities until the market improved. For the well off, that might work. But the 20 percent of retirees who have no other income but Social Security, and the two-thirds who depend on it for more than half their income, might not be able to wait.

Drawing (Drawing by M.K. Perker)