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For release: December 9, 1996

ST. LOUIS -Advocates for reform of Social Security contend that the system must overcome some major obstacles to stay intact, including a huge baby boomer population nearing retirement and the system's "pay-as-you-go" financing structure. In addition, they criticize the low financial returns that the system generates for both current and future recipients.

"Social security experts are divided, however, on whether the system needs only minor tinkering or more serious overhaul," said Michelle Clark Neely, an economist at the Federal Reserve Bank of St. Louis, in the current issue of ***The Regional Economist***, the St. Louis Fed's quarterly magazine of business and economic issues. "Given the high stakes, the choice should not be made hastily or lightly," she added.

Among the system's demographic problems, Neely said, is that the number of workers supporting retirees and the disabled has been declining for decades, a trend that is expected to continue well into the next century as the baby boomers begin to retire in 2010. Compounding that is a drop in the U.S. birthrate and a continuing increase in life expectancy.

Neely also noted that Social Security benefits will exceed payroll tax income by 2012 and will exceed total income (payroll taxes plus interest income) by 2019. In short, without a major change to Social Security, most experts believe that unless the government borrows to make up the shortfall, taxes will have to be raised, benefits will have to be decreased, or both, to meet future obligations.

These and related issues are being addressed by an advisory council that is appointed every four years to, among other things, comment on Social Security policy issues. The council appointed in 1994 is expected to issue its policy recommendations at the end of this year. According to Ed Gramlich, a University of Michigan economics professor and head of the council, there are three proposals to fix the system:

- **Maintain Benefits Proposal**

  With the objective of maintaining the current system, benefits would be subject to tougher tax treatment and a portion of the system's trust funds would be invested in stocks. "The shift from government securities to stocks is controversial," said Neely. "If stocks don't perform as well as they have historically, the Social Security system would have a whole new set of financial and credibility problems."

- **Individual Accounts Proposal**

  The primary objective of this plan is to scale back benefits to erase the long-term imbalance in Social Security. As a first step, the normal retirement age would be raised. Second, the ratio of benefits to contributions for high-wage workers would be gradually scaled back. Third, and most important, this proposal would establish individual savings accounts equivalent to 1.6 percent of payrolls. Although the accounts would be in the Social Security system, individuals would direct their contributions to specific investments.

- **The Personal Security Accounts Proposal**

  This plan proposes even larger individual accounts. Under this proposal, 2.4 percentage points of the current 12.4 percent payroll tax will be designated for survivors and disability insurance. The remaining 10 percentage points of the tax would be split equally and directed to a Flat Social Security benefit equal to two-thirds of the poverty line, which would be financed by employers and administered by the Social Security system, and an individual personal security account (or PSA), which would be financed by employees and managed by private, registered investment companies.

Neely said U.S. policymakers may want to consider the experience of Chile, which scrapped its pay-as-you-go public pension program for a privatized system in 1981. "By most accounts, Chile's new system is an unqualified success," she said. "Real rates of return have averaged 14 percent since the program's inception in 1981. The transition to a similar system in the United States, however, would not be as smooth because of marked political, economic and demographic differences between our two countries. First of all, Chile created its program under a dictatorship, which meant it didn't have to answer to special interest groups or Congress. In addition, at the time of the transition, Chile was running a budget surplus and had nine persons of working age supporting each retiree, versus five workers per retiree in the United States."

What kind of reception the new proposals will receive from both policymakers and the public when they are unveiled in detail, however, is uncertain. Each of the proposals has, of course, its relative strengths and weaknesses not to mention political pitfalls and emotional factors. "For 60 years, Social Security has largely met its goal of providing a socially adequate retirement for the nation's elderly, regardless of their income," Neely said, "but it has some long-term problems that can't be ignored."

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