http://clevelandfed.org/research/trends
June 1997
Best available copy

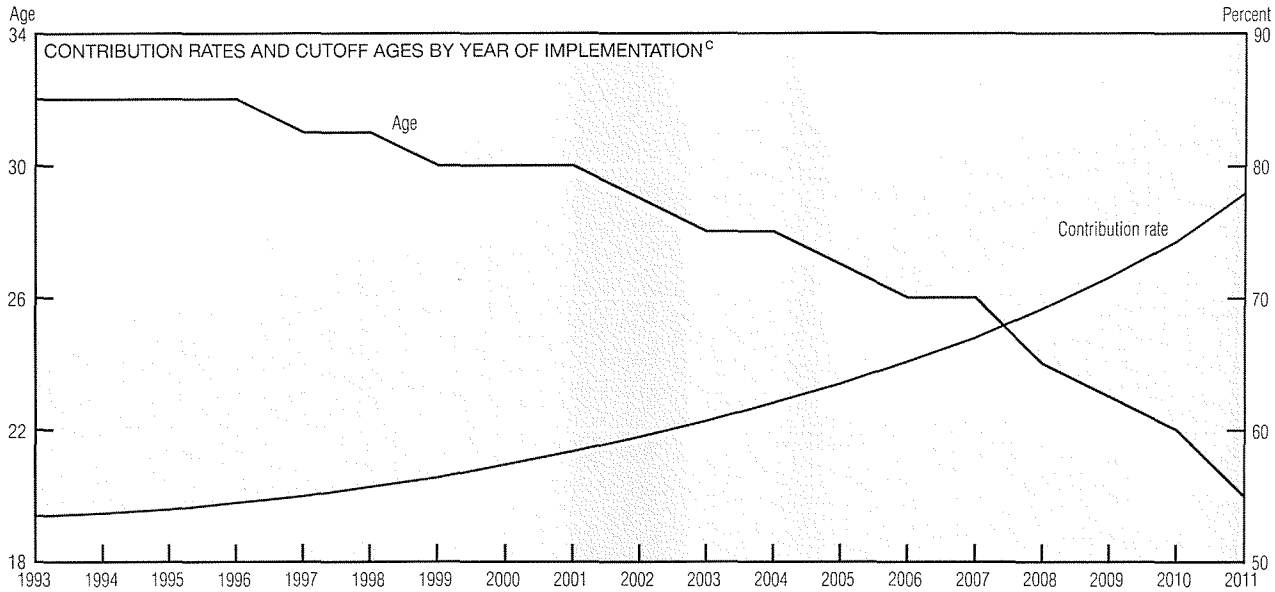
# Social Security—A Solution

**Cutoff Ages under Proposed Plan[a]**

| Rate of return on private capital | Benefit discount rate 5% | 6% | 7% | 8% |
|---|---|---|---|---|
| 6% | 26 | 26 | 26 | 27 |
| 7% | 30 | 29 | 29 | 30 |
| 8% | 33 | 32 | 32 | 32 |
| 9% | 35 | 34 | 34 | 34 |
| 10% | 37 | 36 | 36 | 36 |

**Percent of Contribution Invested in Private Capital Markets[b]**

| Rate of return on private capital | Benefit discount rate 5% | 6% | 7% | 8% |
|---|---|---|---|---|
| 6% | 51 | 49 | 50 | 50 |
| 7% | 50 | 47 | 47 | 46 |
| 8% | 50 | 46 | 45 | 44 |
| 9% | 50 | 46 | 44 | 43 |
| 10% | 51 | 46 | 43 | 42 |




a. Maximum age for shifting workers to the proposed plan.
b. Indicates the percent of contributions of those shifted that can be invested in private capital markets.
c. Shows the contribution rate and tax rate necessary to fulfill the current system's liabilities.
SOURCE: David Altig and Jagadeesh Gokhale, "Social Security Privatization: One Proposal," The Cato Project on Social Security Privatization, SSP No. 9, Washington, D.C., May 29, 1997.

Raising taxes and cutting benefits are politically unpopular options for restoring solvency to the Social Security system. Tax hikes would increase disincentives to work and save. Benefit cuts would be unfair to those who have worked and saved with the expectation of receiving current levels of benefits. There is, however, a third option that would retain the benefits of retirees and older workers, and impose no higher taxes on young and future generations. It would also make Social Security sustainable and provide the present level of benefits to young and future workers. This plan involves gradually investing current contributions in private capital markets.

Assuming reasonable private market rates of return (8%) and benefit discount rates (6%), calculations suggest that workers 32 and younger could shift to a privatized system. Of their total contributions, 46% could be deposited in privately managed accounts. The remainder could be used to pay off the old system's liabilities—benefit obligations to those older than 32.

This reform would gradually eliminate the current system's work and saving disincentives and improve output growth. Because it would preserve the benefits of the elderly without increasing the tax burden on the young, it should be politically feasible. Moreover, because it would generate greater retirement income for young and future generations, it would be economically sustainable. The window of opportunity for such a reform is narrow, however. Waiting even a few years to implement it would require lowering the cutoff age and increasing the share of young people's contributions needed to pay off the current system's liabilities to older generations.