

Limitations of the Individual Account Debate

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[1] The latest reports on the lobbying of interest groups at the Social Security Commission hearings are not promising. Groups from both left and right seem to be enjoying themselves immensely at the battle -- as both seem to think that they have veto power over anything that might come close to being considered by Congress. In particular, the sport of the day is over individual accounts -- for some conservatives the sine qua non and for some liberals and cum qua non of reform. Unfortunately, this narrow focus has tended to close off consideration of many of the more fundamental issues facing social security -- issues related to how well it is even performing its primary mission.

[2] Step back from the debate for a minute, and ask what you might want out of a social security system. Protection against poverty in old age must be primary, as it is obvious that the basic motivation for the program's establishment was concern over the plight of the elderly and their relatively low economic status at the time of its creation. Certainly if the old were richer than the young at the time, no social security program like this -- transferring from young to old -- would have been established.

[3] The current system, however, does an increasingly weaker job over time in allocating its additional revenues to providing this protection. There are a variety of reasons. One is that there is a significant growth in single and divorced individuals who will not qualify for spousal or survivors' benefits. These benefits are designed as a pure add-on transfer. Unlike private pensions, the worker does not pay anything more -- either in reduced worker benefits or higher contributions -- for this add-on. Indeed, in extreme cases, a worker can generate several of these spousal and survivor benefits if married to several persons, each for 10 years or more, and other taxpayers have to come up with the money. The growing group of single heads of household and divorced individuals without 10 years of marriage to a single spouse, however, does not have access to these benefits.

[4] Another reason that social security's additional expenditures have weaker antipoverty effects over time is that the system increasingly transfers smaller shares of money to those who are older and in greater need. As individuals have lived longer and retired earlier, they generate benefits further and further from old age -- as defined as the later years of life. For instance, a smaller and smaller percentage increasingly goes to those with 10 years of life expectancy or less.

[5] Another feature we might want out of the system is equal justice under the law or equal treatment of those equally situated. Here again, spousal and survivor benefits are found to be poorly designed. Not only are their antipoverty effects of mixed value relative to other ways of spending the same amount of money, but they create many inequities. In most cases, those couples whose earnings are more evenly split between partners will receive substantially less total benefits than other couples with the same total earnings and tax payments, but less evenly split earnings. For example, a couple with an earnings split of \$25,000/\$25,000 will receive substantially less lifetime benefits than one with a split of \$50,000/\$0.

[6] Yet another equity and efficiency problem with the current system is its bias against those who work more years. The system currently counts only a fixed number of years (35) of contributions in determining benefits. Essentially, the top 35 years of earnings are averaged, and then the benefit is based on those average earnings. The goal apparently was to provide some bonus to those who might be unemployed for a few years, but, in fact, the benefit also goes to those who simply work less because they are in graduate school, decide to retire earlier, or are simply lazier than the next worker. Thus, a worker with earnings of \$50,000 for 35 years gets a significantly higher benefit than one with \$35,000 for 50 years.

[7] Still another issue is the way the current system provides benefits up front at the beginning of retirement

-- when support is needed less. Start with the same level of lifetime benefits (valued at what an insurance company would charge up front for an annuity). Social security is designed to spread out those lifetime benefits so that retirees get the same level of real benefit over time.

[8] The difficulty is that individuals are typically in greater need when older, when they are less capable of work, when their spouses (if any) more likely have died and cannot help them with impairments, and when health problems increase. Besides, most private pensions and annuities are not adjusted for inflation, so that their real value erodes over time, and the annual income of the typical retired family typically falls during retirement. Meanwhile, the real costs of many items such as nursing goes up. These changes over a retired lifespan might not be so bad if they occurred only over a few years, but remember that for a typical couple benefits are provided for about a quarter-century and for many much longer.

[9] Avoiding the discouragement of work is yet another feature we would want in our system. In addition to not gearing benefits to when needs are greatest, however, the pattern of higher income earlier in retirement years encourages people to drop out of the labor force. Individuals go into retirement thinking their annual annuities are adequate, but they haven't really planned 25 or more years in advance when the real costs of living rise and private pension benefits fall. If the same social security lifetime benefits were allocated more in later years, they would provide less work disincentive in earlier years, and retirees would benefit both from a compensating level of higher social security benefits in later years and the higher earnings in earlier years, some of which could be saved to meet needs of old age.

[10] This list of problems in the current system is hardly exhaustive. The individual account fight unfortunately has deflected concerns away from these types of vital issues. Like Constantinople caught between warring factions on both sides during the Crusades, the basic goals of social security are in danger of being slaughtered by the religious zealots who have made individual accounts their only Jerusalem.

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