Commentary

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BUFFIN PARTNERS INC. ECONOMIC INVESTMENT AND ACTUARIAL RESEARCH

# Redesigning the US Social Security System

The United States faces a number of challenges regarding the adequacy and efficiency of its system of providing old-age income support. We were recently asked how the US Social Security system might be redesigned if it were possible to start afresh today but with the benefit of the knowledge of how the system has fared since its inception. Designing US Social Security based on lessons from experience since the 1930s would undoubtedly result in a system that differs in significant ways from the current system. The specifications for coverage, benefit amounts, and financing arrangements would be very different. A redesigned system might comprise a three-tiered structure that would provide a universal basic benefit for all eligible persons in the first tier; the second-tier benefit would be based on national average earnings and active participation in the workforce; the third tier would offer voluntary national savings and retirement accounts with tax-deferred incentives.

With respect to coverage, the principle of universality would apply; all US persons, whether or not employed in the workforce, whether in the formal or informal sector, or whether classified as lifetime poor, would be entitled to a basic subsistence-level first tier old-age monthly income benefit. This benefit would not be means-tested and would be payable to all individuals without regard to marital or family status or living arrangements. Entitlement to this first tier benefit would require a minimum residency period in the US and would be similar to the New Zealand Superannuation system in terms of design and administration. In today's environment the first-tier monthly benefit for old-age income support would be approximately $400 and would be determined each calendar year as 1% of the latest national average annual wage index amount. The first tier of the Social Security system would be financed from general revenues of the Federal Government. There would be no payroll taxes and no separate Trust Fund. General revenue sources would include income taxes, a national value-added consumption tax, and corporate taxes. The first tier of the system would operate entirely on a pay-as-you-go basis.

The second tier of the system would be structured as a defined benefit system. Benefits would be payable on meeting specific eligibility requirements for old-age, disability, and survivorship that are broadly similar to the corresponding provisions of the current OASDI system. This employment-related second tier would provide benefits based on participation in the national workforce; a retirement benefit for all employed persons would be provided, determined by a formula consisting of two elements, namely, number of years of participation in the workforce and the national average earnings level; the monthly normal retirement benefit formula would be 1% of national average monthly earnings multiplied by the number of years of workforce participation up to a maximum of 40 years.

The second tier of the system would be funded by means of a National Workforce Pension Fund (NWFPF) based on 75-year actuarial projection methodology, with the annual funding requirement expressed as a level percentage of Gross Domestic Product. The annual funding requirement would be met from general revenues of the Federal Government and would be invested in the Fund. The NWFPF would be administered by an independent Investment Board with an investment mandate that would include a broad range of asset classes including equities and real estate; no part of the NWFPF would be available for use by the Federal Government and there would be a specific prohibition against investing in any kind of government securities and against lending to the Federal Government for any purpose. The principal source of funding for this second tier of the Social Security system would be reflected in a restructuring of the corporate tax system and would place a clear responsibility on all corporations and employers for the adequate funding of workers' Social Security benefits on an aggregate macroeconomic basis.

The third tier of the Social Security system would be designed to encourage individuals to take responsibility for making adequate supplemental provision for their own economic security by means of a national savings and investment program. Participation would be entirely voluntary; all contributions and investment income and capital gains would be tax-deferred until the commencement of any benefit payout. There would be a central National Savings and Investment Fund (NSIF) comprising several choices of investment strategies that reflect various asset class allocations and risk profiles. Individual account balances within the NSIF would be available for use for supplemental old-age income provision by annuitization; account balances would also be available as a source of funding for home purchase or for family education expenses such as college tuition.

**NOTE:** KEN BUFFIN, AUTHOR OF *COMMENTARY*, HAS ALSO WRITTEN A MODIFIED VERSION OF THIS ARTICLE ON *REDESIGNING THE US SOCIAL SECURITY SYSTEM* THAT APPEARS IN *CONTINGENCIES* PUBLISHED BY THE AMERICAN ACADEMY OF ACTUARIES.

Buffin Partners Inc.

P.O. Box 1255
Sparta, NJ 07871
Phone: (973) 579-6371
Fax: (973) 579-7067
Email: commentary@buffinpartners.com