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Minimum-Wage Millionaires

By SAM BEARD

Any American currently earning \$10,000 a year pays \$23.85 a week, or \$1,240 a year, into Social Security. Imagine that, beginning at age 20, you invest that \$23.85 a week at market rates. When you retire at age 65, you'll be a millionaire (before inflation). All that on the minimum wage.

For the past two years I have been exploring ways of saving the Social Security system, which celebrates its 60th birthday today. In the process of developing a system to make sure that all Americans will be secure in retirement, I've hit upon a substantial bonus: the opportunity to accumulate capital for ourselves and our heirs. The plan keeps Social Security as a mandatory, redistributionist savings program, but converts the program from the current pay-as-you-go system to a funded system, in which the individuals own retirement portfolios at Social Security and choose private investment managers. Individuals would be allowed to set aside portions of their Social Security payments, together with additional voluntary contributions, in their own personal accounts. They could use their accounts for retirement income and pass on the capital tax free to their children.

The Way It Works

How can we afford to set aside all these savings into individual retirement accounts and, at the same time, meet our obligations to current beneficiaries—all without raising taxes?

We can do this with a plan that has the following basic elements:

Divide Social Security into two tiers. If you are working now, you and your employer would continue to pay existing So-

cial Security taxes of 12.4% on the first \$61,200 of your income. A portion would pay the benefits of existing recipients and a portion would go into your own personal account. Payroll taxes would stay at their current level and, as the system matures, would be cut by two percentage points.

While those now retired would be paid out of the first-tier (current payroll taxes), those now working would draw benefits from two Social Security sources: income from future payroll taxes and from their personal retirement accounts.

The second tier would consist of personal investment and retirement accounts for every worker. This account could be used only for retirement; you could not withdraw funds for any other reason.

The first \$500 you and your employer pay into Social Security every year would be automatically deposited in your personal retirement account. Deposits could be increased up to \$3,000 per year by making voluntary contributions matched by Social Security taxes you are already paying. The size of the match would vary according to income. For example, if you are an individual earning \$30,000 per year, you pay \$3,720 to Social Security. The first \$500 would be paid into your account; you would add a voluntary savings match of \$338. Social Security would then deposit an additional \$722 of money you are already being taxed into your personal retirement account, for a total of \$1,560 a year. In 45 years, your portfolio would be worth \$1,291,433.

Following the formula, if you earn \$75,000 a year and set aside the maximum, \$3,000 per year (\$1,500 from taxes you are already paying and \$1,500 as your personal savings match) into your personal account at Social Security, in 45 years, your portfolio would be worth \$2.5 million.

This money would be in your name, you

would own it and you would be in charge of selecting an investment manager to invest it for you. Social Security would set up an independent corporation to certify and approve private sector money managers; you would pick your manager from the list and could switch any time you wanted.

The new system would put the power of compound interest to work to save Social Security. By 2025, when the pressure of the baby boomers will cripple the old system, over \$100 billion per year of benefits would be paid by income from the accumulated capital of retirees. By 2050, the income from capital could pay over \$400 billion per year of benefits to seniors.

What if your portfolio isn't large enough to provide current levels of retirement income paid by Social Security? You would receive benefits from two sources: income from your capital and the remainder paid by Social Security taxes from those in the work force. As an example, if you have \$150,000 in your personal account and promised Social Security benefits of \$12,000 a year, you would receive \$7,500 in Social Security income from your capital (5% of principal) and \$4,500 through regular payroll taxes.

To make any solution work, there must be cost reductions in the current system. Benefits mandated under the current system cannot be maintained after 2020. There is no realistic plan that leaves Social Security benefits at currently promised levels. Most plans take a middle course,

proposing raising payroll taxes 1% to 2% and cutting benefits 10% to 15%. But the American people are unlikely to accept such tax increases. Therefore, benefits need to be cut to remain in line with existing 12.4% payroll tax levels.

A New Revolution

Americans today feel that they are on a treadmill. They are angry and very distrustful of government. A new revolution redefining the role of government as it affects people's lives and pocketbooks is under way. Individuals want to feel that they control their destiny.

Under the old system, everyone loses. Taxes will increase. Benefits will decrease. People will work harder and see less take-home pay. Savings will decline and the American economy will suffer. Under the new system, we could reverse this downward path and release unprecedented economic growth.

In the process of developing a system to save Social Security, I've hit upon a substantial bonus: the opportunity to accumulate capital for ourselves and our heirs.
