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Social Security Compromise

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A recent proposal by Rep. Rahm Emanuel, chairman of the House Democratic Caucus, may point the way to a bipartisan compromise on Social Security. The essence of Mr. Emmanuel's proposal, unveiled on these pages last month, is to create universal personal retirement accounts funded by equal 1%-of-earnings contributions from employers and employees. Although enrollment would be automatic, participation would be voluntary since each individual could choose to opt out in any year.

The Emanuel plan has much in common with earlier proposals by President Bush. Both approaches call for the funds in personal retirement accounts to be privately managed in a mixture of debt and equity funds. Experience with automatic enrollment plans in private firms shows that almost all employees remain enrolled. A subsidy for low-income individuals, comparable to the tax benefit for savers in IRAs and 401(k) plans, would guarantee their participation. The accounts would provide annuity benefits when the individuals reach retirement age and could be bequeathed if the individual dies before retirement.

As a candidate in 2000, George Bush called for personal retirement accounts to supplement the traditional tax-financed Social Security benefits. As president, he appointed a bipartisan commission headed by Sen. Pat Moynihan and Time Warner CEO Richard Parsons that came up with three alternative ways to use personal retirement accounts to supplement future Social Security benefits.

Unfortunately, Democratic critics argued that individual accounts would be "gambling" with the retirement savings of working men and women. Moreover, congressional Democrats refused to begin a dialogue with the administration, even when the White House insisted that every aspect of its plan was negotiable.

The partisan character of the attack was ironic since President Bill Clinton had used a State of the Union address to emphasize the need for fundamental Social Security reform, and had spoken favorably about the potential role of individual accounts. The Clinton White House and Treasury developed a detailed plan based on such accounts. President Clinton met with Bill Archer, then the Republican chairman of the House Ways and Means Committee, to discuss Mr. Archer's proposal for Social Security reform with personal retirement accounts.

The record strongly suggests that President Clinton was on his way to proposing a Social Security reform with personal retirement accounts. This didn't happen because the Democratic leadership in Congress wanted to use the Republicans' investment-based approach to Social Security as an issue in the 1998 election and persuaded President Clinton to drop his proposal.

The Rahm Emanuel proposal, coming from the chairman of the House Democratic Caucus, looks like an important signal that a compromise may now be possible between Republicans and Democrats along the general lines originally proposed by President Bush. There would of course be many details to be negotiated. But the basic idea of combining traditional tax-financed Social Security with investment-based personal retirement accounts looks like it can be on the table.

As both President Bush and Mr. Emanuel emphasized, personal retirement accounts would increase individuals' confidence in their retirement incomes and would raise our national savings rate, contributing to faster economic growth and less dependence on capital inflows from abroad. The creation of personal retirement accounts can also be a first step toward correcting the fiscal problem of Social Security.

As everyone now recognizes, the current 12.4% Social Security employer-employee payroll tax will not be enough to finance the benefits specified in current law as the population ages. Continuing to finance those benefits with a pure tax-financed system would require raising the payroll tax rate to more than 18%, or finding other ways to raise tax revenue.

The historic returns on stocks and bonds, however, imply that a 2% contribution to personal retirement accounts would eventually generate enough retirement income to maintain the monthly benefits specified in current law, without any increase in taxes. Such is the power of investments in stocks and bonds that 2% of payroll contributions to personal retirement accounts would eventually do the work of a 6% tax-rate increase.

Reforming the tax-financed Social Security benefits to avoid a future fiscal shortfall is a bridge that need not be crossed now. The important point is to start the personal retirement accounts as soon as possible. The rapid aging of the population and the imminent start of the baby-boom generation's retirement make it important to avoid delay. The White House and congressional Republicans should reach out to Mr. Emanuel to see if the compromise needed to save Social Security and increase savings can now be achieved.

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