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Saving and Protecting Social Security *A Plan to Ensure Retirement Security for All Americans*

The Plan

Since its inception, Social Security has done a good job of reducing poverty rates among the elderly, reducing them from 35% in 1959 to 9.4% in 2006. The current program, however, is fiscally unsustainable. Social Security actuaries warn that if nothing is done, the Social Security Trust Fund will run out of money around 2041. When that happens, retirees will face an immediate 23 percent cut in their benefits. Or, Congress could change the law and impose a 30% increase in taxes just to sustain the promised benefit level. Without question, therefore, future generations of Americans will not have the same retirement system that current seniors enjoy available to them unless the Social Security program is transformed and saved. Few young workers today have confidence that Social Security will be there for them when they retire.

While 2041 sounds as if it is far off, one-third of the people now in their fifties and the great majority of people younger than 50 will be collecting benefits when Social Security runs out of money thirty-four years from now. Fred Thompson believes that we cannot afford to wait, because the longer we do the larger the problem grows. Rather, we need to take action now to save and protect Social Security and put it on a sustainable path for our children and grandchildren. The longer we delay reform of the current system, the more draconian the reforms will have to be.

We still have time to save Social Security, protect it, and provide a more secure retirement for all American workers...if we act now.

Goals for Saving and Protecting Social Security. Fred Thompson's plan will achieve the following:

- Leave the Social Security benefits received by current and near retirees completely unchanged and fully preserve their annual Cost of Living Adjustments.
- Preserve and strengthen Social Security for future generations of Americans and guarantee the current level of benefits fully protected for inflation.
- Help build personal wealth in America by expanding the ownership of financial assets to more Americans.

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- Increase retirement options for future retirees by giving them the means to decide when to retire and allowing them to build wealth that they can pass on if they so choose.
- Completely eliminate the estimated \$4.7 trillion unfunded Social Security liability over the 75 year actuarial planning horizon and leave Social Security on a fiscally sustainable basis.

This plan also will *not* affect the benefits either of current or near retirees. This plan will *not* affect the manner in which the annual cost-of-living adjustment (COLA) is calculated for either current or future Social Security recipients. Instead, this plan will actually provide the means and opportunity for current workers to have *more* money at retirement and more choices on how to use that money than does the current Social Security system.

Plan for Saving and Protecting Social Security. Fred Thompson's plan has two key elements:

- Provide Voluntary Personal Retirement "Add On" Accounts to Supplement Benefits
- Index the Social Security Benefit Formula for Prices, Not Wages

Each of these key elements is explained in detail below.

I. Provide Voluntary Personal Retirement "Add On" Accounts to Supplement Benefits

As America ages and there are more retirees for each worker, Americans will have to rely on something other than the taxes of current workers and their employers to finance their retirement.

In the last sixty years the average return on stocks has been over 7 percent after adjusting for inflation.

Fred Thompson believes that workers should have the option of making contributions to *voluntary* Personal Retirement Accounts, which will work like a 401(k) plan, and thereby permit all American workers to participate in the expansion of wealth in America. Specifically, he proposes that Social Security establish voluntary Personal Retirement Accounts (PRAs) for which:

- Each worker would automatically contribute 2% of his/her wages into a voluntary Personal Retirement Account.
- This employee contribution would be matched by 2.5 for 1 (\$2.50 for every \$1 dollar contributed) on the contributions from the first \$1000 of wages earned each month. The match would be made from existing contributions.

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- All additional contributions would be matched fifty cents on the dollar.
- If a worker does not want to participate in the voluntary PRA, he/she could “opt out” of the program at the beginning of each year.

Under this plan, a worker making \$20,000 per year would end the year with a \$1080 account: \$400 of worker contributions and \$680 in matching contributions. A \$40,000 worker would end the year with \$1680: \$800 of worker contributions and \$880 in matches. A worker earning \$80,000 would accumulate \$2880: \$1600 in worker contributions and \$1280 in matches.

Both the worker's contribution and the match, at his/her direction, would be invested in stocks and/or bonds through investment mechanisms that work like the federal government's Thrift Savings Plan or private-sector 401(k) plans that allow workers to choose from a menu of qualified plans. Workers also could select a plan in which the real value of their personal contributions is fully protected against inflation, while the remaining contributions are put in a stock fund that would provide a net "upside" return for them.

Assuming a 5 1/2 percent weighted average real return, the \$20,000 worker would accumulate more than \$180,000 over 45 years; the \$40,000 worker would have about \$280,000; and the \$80,000 worker would have \$440,000 -- all in inflation adjusted dollars.

This money belongs to the worker. It could be withdrawn at the worker's discretion after age 62 and used for any purpose, or left in the account to continue growing. If the worker should pass away, it would be inherited by his or her designated beneficiaries.

Voluntary PRA Offset

The Personal Retirement Accounts (PRAs) established under this plan give workers more choices once they reach age 62: to retire early with a sizable next egg, or to retire later and continue contributing to their PRAs with a government match. These are options not available under the current system. In order to provide workers who choose to invest in PRAs these choices, while preserving the solvency of the system, their matching contributions would be offset by delaying eligibility for monthly Social Security benefits. Workers who want to retire early, however, could use their personal account to buy an annuity that would more than cover the offset. They could also choose to take minor reductions in the monthly benefits received, just as they can today.

Workers aged 45 to 60 would have a delay in the receipt of their monthly benefits of one month for every year they participated in the system, or they could take a benefit reduction equal to one-half of 1%. Workers under 45 would have a 2-month delay in their eligibility for monthly benefits, or take a 1% reduction in benefits.

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The effect of this change on a worker could easily be calculated. A worker earning \$40,000 who started participating at age 22 and worked until age 67 would accumulate over \$280,000. The offset from monthly benefits would amount to \$470 less per month. However, assuming a 5 1/2 percent return on the \$280,000, this reduction would be more than offset by drawing from the interest earned on the accumulated \$280,000 nest egg. This interest income would provide the worker \$1283 per month, in addition to his/her monthly benefits. Even then, the retiree would still have the \$280,000 principal left over which he or she could spend later in life or leave to heirs.

Contribution to Trust Fund of Extra Tax Revenue Collected on Personal Account Investments

Under the Thompson plan, substantial funds would accumulate in the Personal Retirement Accounts of individuals over time. A portion of this capital would represent increased net saving for the American economy and allow U.S. corporations and businesses to increase their invested capital faster than they otherwise would. In turn, this increase would produce a larger economy and higher tax revenue, particularly corporate tax revenue. Following the analysis first proposed by Prof. Martin Feldstein and Andrew Samwick, the Thompson plan would transfer, by law, from the general fund to the Social Security Trust Fund an amount equal to 1% of the Personal Retirement Account balance. This calculation is likely a conservative estimate of the actual increase in the revenue collected by the general fund as a consequence of the creation of the Personal Retirement Accounts.

II. Index the Social Security Benefit Formula for Prices, Not Wages

We must protect current and near retirees' benefits and preserve the Social Security program for future generations. Current law promises future retirees more benefits than current retirees with the same real income even though they paid the same real amount in taxes. That promise is one the current system cannot keep. Instead, current law effectively requires a 23% across the board reduction in benefits when the Trust Fund runs out of money, an event currently projected to occur in 2041.

The reason for the promised but undeliverable increase in benefits for future retirees is that current law calculates a worker's initial benefit by a formula that depends on how fast wages grow. After the initial benefit calculation, Social Security benefits are indexed annually to price inflation. This formula leads to the result that two workers with exactly the same real incomes who contributed exactly the same inflation-adjusted amount in payroll taxes will get different benefits, depending on when they retire. For example, a worker who earned an inflation-adjusted \$40,000 all his or her life and retired this year would get a benefit of \$1493 a month, but a younger worker with exactly the same real income would get an inflation-adjusted benefit of \$1676 per month upon retirement in 2047.

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We can afford to guarantee all workers the current benefit formula, fully indexed for inflation. But, with a system that is running out of money, we cannot and should not promise to increase benefits that we cannot pay for. The Thompson Plan to Save and Protect Social Security will--

- Leave all current and near beneficiaries completely untouched. No one now over 57 will be affected by this plan at all.
- Maintain the current level of real benefits for future workers
- Not affect the COLA calculation for Social Security benefits now or in the future.
- Ensure the Social Security program does not run out of money.

Under the Thompson plan, the Social Security system is balanced actuarially over the 75-year planning period the Social Security actuaries use to determine Social Security's long-term viability. That means that unlike under current law, the cash flowing into the system will balance the cash flowing out of the system over the next 75 years. Social Security is now running a surplus and is therefore a net lender to the general fund. Under the Thompson Plan, should the Social Security Trust Fund have a deficit, it would temporarily become a borrower from the general fund. It would then be able to fully repay the general fund once it again ran a surplus. In this way the system would be protected from insolvency and retirees would not be forced to take a sudden benefit cut. Moreover, under the Thompson plan, the Social Security system would be running surpluses at the end of the 75-year period, assuring that Social Security will remain permanently solvent.

Summary

We face a choice as a country-either take no action (and ask the American people to swallow dramatic benefit cuts and/or tax increases in the future) or take action now to save and protect Social Security. It is not realistic to compare the current system with any reform plan, because the current system is failing due to the increasing number of retirees and decreasing number of workers that can support them. Rather, the comparison to be made is among competing reform proposals. To date, however, not a single other candidate has come forward with any real proposal to save Social Security, so no comparisons are possible. Fred Thompson has chosen to speak candidly to the American people and act responsibly by presenting them with his plan to fix the problem. The Thompson Save and Protect Social Security plan will preserve real benefits at current levels, give workers a piece of the ownership society if they so choose, and save Social Security for future generations. This is critical to America's long term Security, Unity, and Prosperity.

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