Senators Cassidy and King Have a Plan for Saving Social Security

May 8, 2023

MarketWatch Blog by Alicia H. Munnell

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It involves equities in a trust fund, but our trust fund is headed to zero.

Apparently, Senator Bill Cassidy (R-LA) is working with Senator Angus King (I-ME), who caucuses with the Democrats, to craft a bipartisan solution to fix Social Security. Their plan involves creating a fund outside of Social Security that could be invested in equities and using the earnings on that fund to help pay promised benefits. The plan is still a work in progress, but raises some interesting issues.

On the positive side, a good case can be made for investing some Social Security trust fund money in equities. They yield higher returns relative to safer assets and have the potential to reduce reliance on the payroll tax. Other countries, such as Canada and Japan, do it successfully, so precedents exist. **Some work we did** a few years ago showed that if the United States had invested in equities as late as 1997, we would not be facing the imminent depletion of trust fund reserves today. And it's easy to address the critics' concerns.

- *Market disruption*: Some critics worry that Social Security holdings would disrupt the stock market. Our previous analysis found that if the trust fund limited its investment to 40 percent of total assets, its holdings would amount to less than 4 percent of the market. As a point of comparison, state and local pension plans currently hold about 4.5 percent of total equities, and no one says that those plans are disrupting market activity.

- *Stock picking*. A second concern is that the choosing of investments and voting of shares would be politicized. In fact, the government would likely take a very passive role. It could establish an expert investment board – similar to that for the federal employees' Thrift Savings Plan – to select a broad market index and delegate proxy decisions to the individual portfolio managers.

- *Misleading accounting*. The third concern is how to account for the higher expected returns from equities without giving the impression that the government could solve all its problems simply by selling bonds and buying stocks. One approach is to follow the Congressional Budget Office and report equity returns on a risk-adjusted basis, and credit gains only after they have been realized.

So, if Social Security had a trust fund, some equity investment sounds like a great idea.

The problem is that Social Security's small existing trust fund is heading quickly towards zero. So, the first step in any proposal for equity investment is channeling some money into the Social Security trust fund or – following

Cassidy/King thinking – into a fund outside of Social Security. Only two options exist for getting the trust fund some money – raise taxes or borrow the funds. Borrowing more money when we already have $31 trillion in debt sounds like a terrible idea. Therefore, a moderate tax increase is the only sensible option, and the logical source of money is the income tax.

But the second thing I really worry about is 2034 – the year after the retirement trust fund runs out of money. According to the Social Security actuaries, in 2034 the cost of retirement benefits will be $2,200 billion and revenues will be $1,700 billion. If people are going to get their full benefits, Social Security needs an additional $500 billion, and the annual amount to cover the shortfall increases each year thereafter. So, building up a trust fund seems like somewhat of a luxury in view of the system's cash flow needs.

The higher priority in my view is identifying a source of revenue to fill the annual gap between promised benefits and payroll tax revenues. That gap exists precisely because we have a **"Missing Trust Fund"** where workers could invest their contributions and earn returns. We gave away that trust fund in the early years of the program to retirees who received benefits far in excess of contributions. Since we are missing the trust fund, we are also missing the interest that such a fund would provide. We should use general revenues to compensate for the "Missing Interest" and require workers to contribute only the amount required in a funded system. This approach would distribute the historical burden more broadly, but the sense that workers pay for their own benefits would remain.

I wish Social Security had a sizable trust fund and that we could invest some of those ample assets in equities. But it doesn't. So, it's not clear to me what Senators Cassidy and King are thinking.