The Social Security Trust Fund should be allowed to invest in equities

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The gains could be sizable and the risks are minimal.

In a recent ***Wall Street Journal* column**, I debated with Michael Tanner of the Cato Institute the merits of investing a portion of the Social Security trust fund in equities. I, of course, think I won that debate! Equity investment would likely increase investment returns, improve the program's long-term financial outlook, and reduce the need for benefit cuts or tax increases. If done carefully, the downside risks are estimated to be negligible.

In **a recent study**, some co-authors and I showed that whether stock investment had started in the early 1980s or late 1990s, trust fund assets would be significantly higher than they currently are, despite the bursting of the dot-com bubble in 2000 and the financial crisis in 2008. We also showed that incorporating equity investment as part of a package of program changes to restore financial balance to the system would produce a better outcome than an all-bond portfolio in 96 percent of simulated outcomes – even if future equity returns turned out to be lower than historical returns.

Moreover, Social Security investing in equities is unlikely to disrupt the stock market. The simulations suggest that the trust fund would be unlikely to

hold more than 2% of outstanding market cap at the end of the projection period. (The typical proposal would increase the percentage of the trust fund invested in stocks by 2 to 3 percentage points annually until stocks accounted for 40% of total Social Security assets.) As a point of comparison, state and local government pension plans currently hold about 6% of total stocks. Social Security wouldn't take over the stock market!

Critics of equity investment sometimes suggest that we will end up with members of Congress lobbying Social Security to buy shares of companies in their districts. But any such risk can be easily avoided. Equity investments could be designed to track a broad market index such as the Wilshire 5000, Russell 2000 or S&P Composite 1500. In terms of corporate governance, the voting rights associated with trust-fund shares could be handled in one of three ways: not voted at all, voted in a pattern that reflects the votes of other common shareholders, or delegated to the individual portfolio managers, which is the practice of the federal government's Thrift Savings Plan.

The real risk is that equity investment looks like it produces magic money. That is, the Social Security program is reported to be immediately better off by selling a $100 bond and buying a $100 stock. If true, why not sell $1 trillion in bonds and buy $1 trillion in stocks, or $10 trillion? In such a scenario, we could eliminate the deficit and all outstanding government debt just by selling bonds and investing in equities. The way to avoid such craziness is to assume that equities will experience the same risk-adjusted returns as bonds – that is, the accounting must be done on a risk-adjusted basis. If investment returns turn out as the simulations suggest, then the gains can be registered in terms of higher trust fund assets down the road.

Equity investment is not a silver bullet that can solve all of Social Security's problems, but it certainly merits consideration as one item in a package

designed to restore balance.

In short, policymakers should include investing Social Security’s assets in equities on their list of options when constructing a comprehensive package to restore long-run balance to the program.