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PRIVATIZING SOCIAL SECURITY: RISKS TO SYSTEM ARE GREATER THAN POTENTIAL RETURNS

Better Remedies Exist to Safeguard Social Security for the Future

ANNANDALE-ON-HUDSON, N.Y.--With the baby boom generation nearing retirement, safeguarding Social Security for the future will require changes to the system. But privatization plans now under debate are risky and unnecessary, according to Walter Cadette, senior fellow at The Jerome Levy Economics Institute.

In his new Levy Institute Public Policy Brief, ***Safeguarding Social Security,*** Cadette contends that the system can be put on a sound financial footing for decades to come with relatively minor changes in tax rates and benefits formulas. He argues that privatization would seriously weaken many of the Social Security system's primary goals, including its capacity to subsidize benefits to low-income retirees.

A privatized system in which a large portion of retirement income would be derived from individually managed security accounts would result in "winners" and "losers," with unlucky and timid investors relying on a severely reduced basic Social Security payment for retirement income. "Privatization offers a poor substitute for the benefit Social Security has offered the nation since the 1930s: a guaranteed base level of income support for virtually all retiring workers, half of whom cannot count on a 'private' pension," says Cadette.

Policymakers should strive to maintain the defined-benefits character of the system, according to Cadette. Among the options he advocates are raising the retirement age, reducing benefits to high-income retirees, and trading off increased survivor benefits against retirement benefits.

Tax incentives to promote saving should play an important role, according to Cadette. "In addition to the obvious benefits of raising the saving rate and helping the baby boomers build capital for retirement, tax incentives to promote saving would also help to soften the inevitably unpopular measures that will be needed to right the system's long-term imbalance," Cadette says.

Building more flexibility into benefits formulas, by linking ongoing as well as initial Social

Security benefits to prevailing wages, and thus to the economy's performance, should be considered, as should shifting the pattern of benefits forward toward later retirement years, Cadette says. He also suggests that the Canadian "double-decker" model, where general taxation finances a flat payment to all beneficiaries and payroll taxes finance an additional payment tied to lifetime earnings, should get a hearing.

"The maintenance of benefits approach advocated by some members of the Advisory Council on Social Security would right Social Security's long-run financial imbalance with minimal dislocation," says Cadette. "Privatization would also remedy the problem, but Social Security would be changed beyond recognition in the process--a steep price to pay for the higher returns some participants might reap."

Public Policy Brief No. 34, ***Safeguarding Social Security,*** *The Challenge of Financing the Baby Boom's Retirment,* 1997

(10/3/97)