

Testimony

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SOCIAL SECURITY

Individual Accounts as an  
Element of Long-Term  
Financing Reform

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Comptroller General of the United States



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# Social Security: Individual Accounts as an Element of Long-Term Financing Reform

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Mr. Chairman and Members of the Committee:

Thank you for inviting me here today to continue the ongoing discussion on how best to ensure the long-term viability of our nation's Social Security program. Demographic trends threaten the program's solvency such that assets could be depleted by 2032. Numerous proposals to restore the Social Security program's solvency have been put forth; as one element of reform, many of these include individual accounts which could provide greater individual choice in retirement investment and increased rates of return.

In my remarks today, I will discuss several different approaches to restoring the Social Security program's solvency and sustainability and the various factors that must be considered in determining whether individual accounts should play a role as an element of Social Security reform. My comments are based on several recent GAO reports and testimonies, as well as our ongoing work.<sup>1</sup>

In summary, Social Security forms the foundation for our retirement income structure and, in so doing, provides critical benefits to millions of Americans. Yet, problems facing this program pose significant policy challenges that we need to address soon in order to lessen the need for more dramatic reforms in the future and to demonstrate the federal government's ability to deal with a known major problem before it reaches crisis proportions. Some proposals suggest adding individual accounts—which are similar to defined contribution plans—to the current defined benefit program. These individual accounts offer the potential for increased investment returns, but they cannot by themselves restore Social Security's solvency without additional changes to the current system. In assessing these proposals, policymakers must consider the extent to which the proposals offer sustainable financing for the system. Also, they must consider how to balance improvements in individual equity (i.e., rates of return on individual contributions) while maintaining adequacy (i.e., benefit levels, certainty) of retirement income for those individuals who rely on Social Security as their primary or sole source of income. And finally, choosing whether to incorporate individual accounts into our Social Security system will require careful consideration of a number of design and implementation issues to determine if such a system would function effectively at a reasonable cost.

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<sup>1</sup>In particular, see *Social Security: Different Approaches for Addressing Program Solvency* (GAO/HEHS-98-33, July 22, 1998).

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## Many Proposals to Restore Solvency Include Individual Accounts

A wide array of reform proposals have introduced the concept of personal or individual retirement accounts into the debate over Social Security's future solvency. In evaluating these proposals we must understand

- Social Security's fundamental role in ensuring the income security of our nation's elderly;
- the nature, extent, and timing of Social Security's financing problem; and
- the differences between the current program and a program that might include individual accounts.

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## Social Security Is the Foundation of Our Nation's Retirement Income System

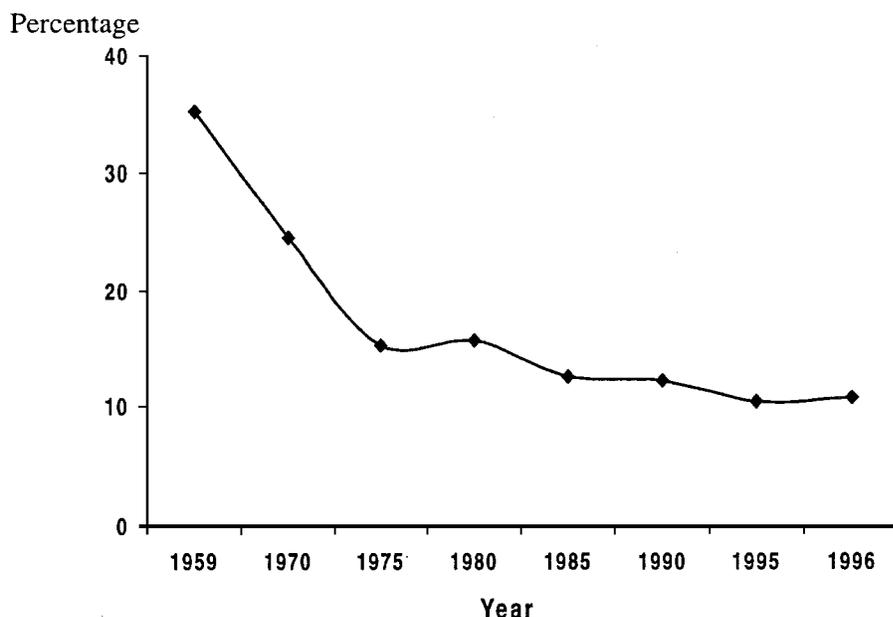
Social Security<sup>2</sup> has long served as the foundation of our nation's retirement income system. That system has traditionally comprised three parts: Social Security, employer-sponsored pensions (both public and private), and personal savings in the form of real and financial assets.<sup>3</sup> Social Security is viewed as providing a floor of income protection that the voluntary forms of employer pensions and individual savings should build upon to provide a secure retirement. However, private pension plans cover only about 50 percent of the full-time work force, and a significant portion of the American public does not have any other significant personal savings. In addition, Social Security is the sole source of retirement income for almost a fifth of its beneficiaries. Given Social Security's importance as the foundation of retirement income security, it has been a major contributor to the dramatic reduction in poverty among the elderly population. Since 1959, poverty rates for the elderly have fallen from nearly 35 percent<sup>2</sup> to 10.5 percent. (See fig. 1.)

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<sup>2</sup>Social Security refers here to the Old-Age, Survivors, and Disability Insurance program, also referred to as OASDI.

<sup>3</sup>For a discussion of this traditional approach to retirement income, see Retirement Income: Implications of Demographic Trends for Social Security and Pension Reform (GAO/HEHS-97-81, July 11, 1997).

Figure 1: Poverty Rates for the Elderly Have Fallen Since 1959



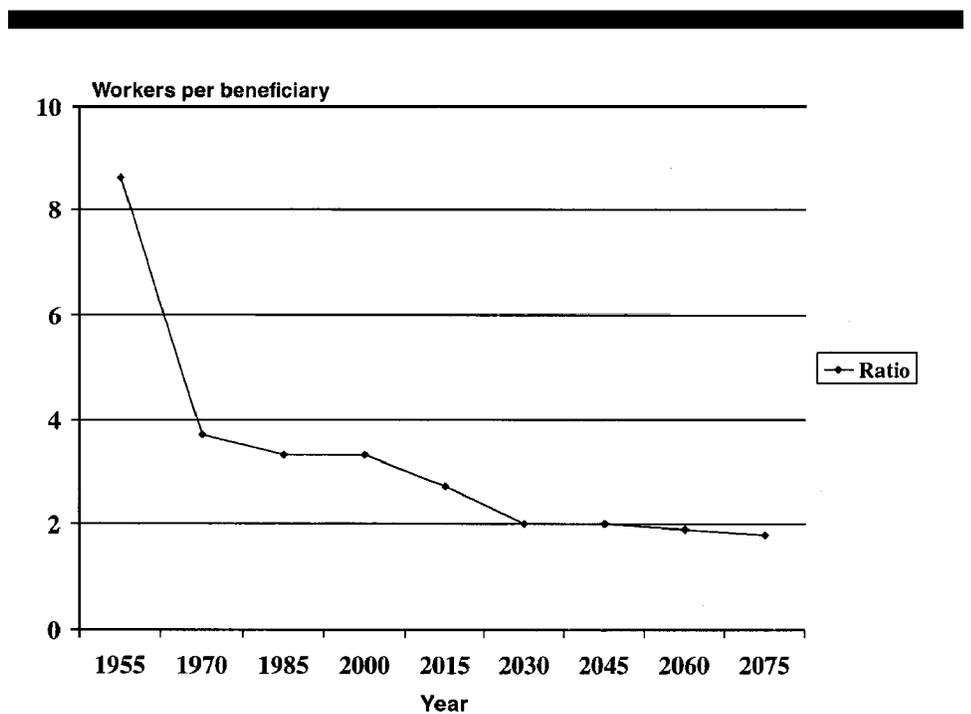
Social Security represents a retirement income insurance program that helps workers collectively pool the risks associated with loss of earnings due to old age, disability, and death. It is a mandatory and almost universal program. As a result, the vast majority of American workers take Social Security credits with them when they change jobs. Social Security also provides inflation-protected benefits for the life of the retiree. No matter how long they live, under the current program design retirees continue to receive Social Security benefits uneroded by inflation. The program, which provides benefits not generally available as a package in the private market, includes benefits for retired workers, their spouses and dependents, and their survivors as well as for the disabled.

### The Financing Problem Needs to Be Addressed Now

The Social Security system has required changes in the past to ensure future solvency. Indeed, the Congress has always taken the actions necessary to do this when faced with an immediate solvency crisis. However, the program faces demographic conditions that require action now to avoid unfairly burdening future generations with the program's

rising costs and to give these individuals time to make the necessary adjustments to their retirement planning. Social Security's financial condition is directly affected by the relative size of the populations of covered workers and beneficiaries. Historically, this relationship has been favorable. Now, however, the covered worker-to-retiree ratio and other demographic factors, such as life expectancy, have changed in ways that threaten the financial solvency and sustainability of this important national program (see fig. 2).

**Figure 2: Ratio of Workers to Beneficiaries Is Declining**



Thus, although the program was put in 75-year actuarial balance just 15 years ago, the Trust Fund balances now are projected to be exhausted in 2032 (as estimated in the 1998 Trustees' Report). In addition, the program will begin to experience a negative cash flow in 2013, which will accelerate with the passage of time. Absent meaningful program reform, this will place increased pressure on the federal budget to raise the resources

necessary to meet the program's ongoing costs.<sup>4</sup> To restore solvency to the program today, we would need to immediately increase annual program revenues by 16 percent or reduce annual benefit payments by 14 percent across the board.

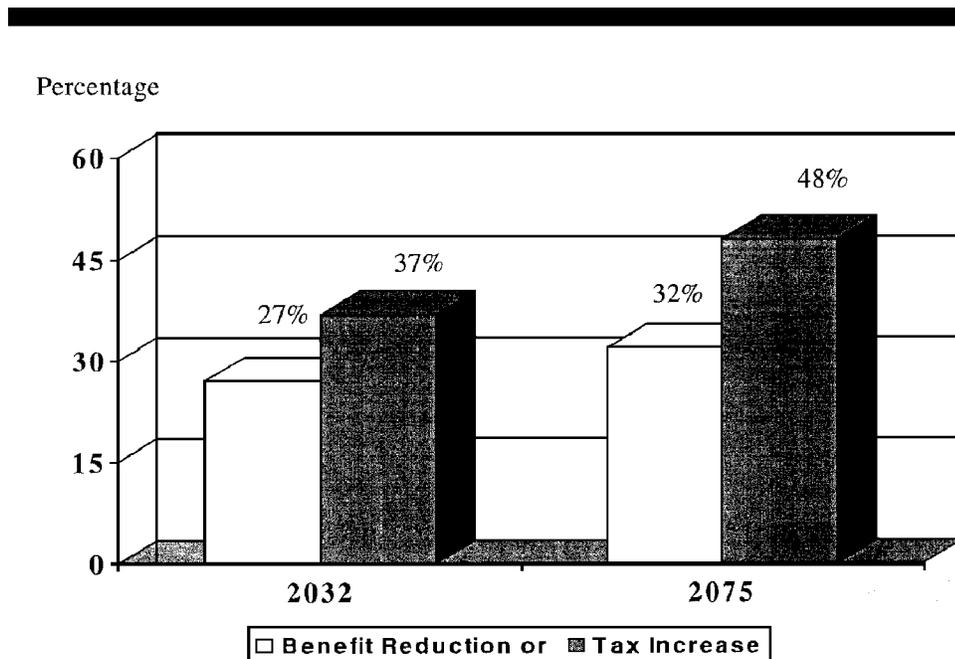
Even if such actions were taken today, attention would need to be given to their sustainability. We measure solvency in this program over a 75-year period. As each year passes, because the system is in temporary surplus, a year of surplus is dropped from the calculation and a year of deficit is added into the 75-year average. Hence, changes made today that restore solvency only for the 75-year period will result in future actuarial imbalances nearly immediately. For this reason, we must consider what is needed to put the program on a path toward sustainable solvency so we will not face these difficult questions on a recurring basis.

Another way to understand the magnitude of the problem is to consider what the system will cost as a percentage of taxable payroll in the future. If we did nothing and let the Trust Funds run out in 2032, resources equivalent to 18 percent of taxable payroll would be needed simply to finance the system in the following year—more than 37 percent higher than the revenues projected to be available under the 12.4 percent payroll tax that currently finances the system (see fig. 3).

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<sup>4</sup>Social Security: What the President's Proposal Does and Does Not Do (GAO/T-AIMD/HEHS-99-76, Feb. 9, 1999).

**Figure 3: Changes Are Needed to Maintain Solvency**



Note: Percentage changes are necessary to maintain solvency for the next year only.

By 2075, the end of the Trustees' current long-term projection period, resources equivalent to nearly 20 percent of payroll—or a 48-percent increase in projected revenues—will be necessary. Alternatively, if we were to address these gaps through benefit reductions, changes equal to 27 percent of benefits in 2032 and 32 percent in 2075 would be required. Clearly, these dates are far off and projections are fallible. For example, stronger economic growth than currently projected would make it possible to meet the program's commitments more easily. Health advances that extend life expectancy beyond current expectations, and other variables, however, could make things worse. In addition, these revenue or benefit changes relate only to one year's financing gap. The percentages would have to be considerably higher to make the program solvent and sustainable over an ensuing 75-year period.

If we do not take measures to recognize and address this entire financing gap, we will have to revisit this difficult debate time and time again. The program's future financial situation calls upon us to make prudent

judgments today that will affect those in the future who will be asked to meet these benefit commitments. Importantly, since we can anticipate this situation, and because our economy is strong, we can act now to avoid more painful decisions in the future.

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### **There Are Many Differences Between the Current Program and One That Includes Individual Accounts**

A wide spectrum of Social Security reform proposals has surfaced in this debate, and they reflect different perspectives and opinions about how best to address the program's financing problem. Let me describe briefly the two main perspectives on the appropriate benefit structure for Social Security, which are analogous to the distinction between defined benefit and defined contribution pension plans.

The current Social Security system's benefit structure is designed to address the twin goals of individual equity and retirement income adequacy. Individual equity means that there should be some relationship between contributions made and benefits received (i.e., rates of return on individual contributions). Retirement income adequacy is addressed by providing proportionately larger benefits (redistributive transfers) to lower earners and certain household types, such as those with dependents (i.e., benefit levels and certainty). The current benefit structure combines these twin goals—and the range of benefits Social Security provides—within a single defined benefit formula. Under this defined benefit program, workers' retirement benefits are based on the lifetime record of earnings, not directly on the payroll tax contributed. Given the current design of the Social Security program and known demographic trends, the rate of return individuals will receive on their contributions is declining. In addition, as noted previously, current promised benefits are not adequately funded over the 75-year projection period.

Alternatively, those who propose individual accounts as part of the financing solution emphasize the potential benefits of a defined contribution structure as an element of the Social Security program and/or financing reform. This approach to Social Security focuses on directly linking workers' contributions to the retirement benefits they will receive. Workers' contributions are invested in financial assets and earn market returns, and the accumulations in these accounts then provide income in retirement. The advantage of this approach is that individual workers have more control over their accounts and more choice in how the accounts are invested. This control enables individuals to earn a higher rate of return on their contributions than under current law. Of course, these opportunities

for higher returns exist because investors assume some measure of risk that the return expected may not actually be realized.

To illustrate the differences between the current Social Security defined benefit structure and a primarily defined contribution structure, we recently studied the experience of three counties in Texas that withdrew from the Social Security system in 1981 and substituted a defined contribution plan for Social Security.<sup>5</sup> The Texas plans offer retirement, survivors, and disability benefits. Although contributions are somewhat higher than those of Social Security, they are roughly comparable when Social Security's financing gap is considered. Benefits are based on contributions and earnings from investments. Under the Texas plans, contributions are invested conservatively in fixed income securities that are readily marketable. We simulated the benefits that typical workers could receive under these plans and compared them with what would have been received under Social Security. We found that for higher income workers the Texas plans provided higher benefits, especially initially. However, because of the Social Security benefit formula "tilt" toward lower earners, many such workers could have done better under Social Security. Other features of Social Security, such as adjustments for inflation, also suggest that many median-wage workers might have done at least as well, if not better, had they stayed under Social Security. However, the Texas plans followed a relatively conservative investment strategy with lower returns than are usually assumed in most individual account proposals. Nonetheless, our analysis does suggest we need to be careful that those most reliant on Social Security are adequately protected.

Some reform proposals incorporating individual accounts address the need for such protection by combining defined contribution and defined benefit approaches into a "two-tiered" structure for Social Security. Under such a structure, individuals would receive a base defined benefit amount with a progressive benefit formula and a supplemental defined contribution account benefit. Individuals could be guaranteed a minimum monthly benefit. This approach, however, raises a number of risks and administrative issues which I will discuss later in this statement.

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## Financing Sustainable Solvency

Financing a sustainable solution relates to how we bring long-range program costs and revenues into balance. Addressing the current projected financing imbalance requires either raising revenues or decreasing program costs. Funding future benefit commitments in light of

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<sup>5</sup>Social Security Reform: Experience of the Alternate Plans in Texas (GAO/HEHS-99-31, Feb. 26, 1999).

changing demographics through higher investment returns can help make the needed measures less severe, and this is one of the reasons many reform proposals include individual accounts.

Still, creating individual accounts does not by itself address the solvency problem. Although individual accounts offer the potential to capture higher investment returns, if the accounts are adopted without the higher returns being shared within the system or without accompanying benefit reductions, the solvency problem will not be alleviated.

The extent to which individual accounts affect long-term solvency depends in part upon whether the accounts are “added on” to the existing system or “carved out” of it. Some proposals add on individual accounts as a type of supplementary defined contribution tier. This approach effectively leaves the entire 12.4 percent payroll tax contribution available to finance the program while dedicating additional revenues for individual accounts. These additional revenues might come from a payroll tax increase or from future unified budget surpluses. However, this approach does nothing to help Social Security unless incremental investment income is used to either supplement Social Security revenues or offset current promised benefits.

The carve out approach involves creating and funding individual accounts with a portion of the existing payroll tax rate. Thus, from the current combined payroll tax rate of 12.4 percent, a portion could be carved out and allocated to individual accounts. The obvious effect is that less revenue is available to finance the current benefit structure, so the system’s solvency is further eroded.

Thus, individual accounts represent a way of using higher rates of return to raise more revenues in the future than does the existing Social Security program. At the same time, including such accounts as an element of reform requires that we consider ways to share the increased returns with Social Security or revise the existing defined benefit structure for future beneficiaries. In other words, to improve Social Security solvency, individual accounts and Social Security reform must be considered together.

In addition, finding the appropriate balance between the defined contribution and defined benefit approaches also has implications for the near-term financing of the Social Security program and its payments to current retirees and those in the near future. If individual accounts reduce

existing program revenues to finance higher returns over the long term, we must still be able to continue to finance ongoing benefits to retirees in the short term. This problem of “transition costs” means that we may have to devote additional resources to the program in the near term. The trade-off is that in the long run individual accounts may, if structured properly, help finance the program in a more sustainable way.

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## **Balancing Equity and Adequacy in the Benefit Structure**

Because individual accounts cannot contribute to restoring solvency without combining with Social Security in some way, it is useful to focus on the implications of individual accounts for Social Security’s defined benefit program. The existing program includes a mix of benefits covering disability, spouses and dependents, and survivors. It also includes transfers to lower earners and families. Some proposals that include individual accounts have been criticized for not fully considering these other benefits when touting the advantages of higher returns on defined contribution accounts. But most proposals address the defined benefit portion by making a number of changes and adjustments to the existing program, and some proposals incorporate a guarantee of current law benefits. I will discuss some elements of these proposals briefly and also address the issue of whether to make the individual accounts mandatory or voluntary.

Decisions about the appropriate balance between the defined contribution and defined benefit portions will need to consider the purpose of the original Social Security program. The altered defined benefit portion will still be relied upon to provide a foundation that ensures an adequate and certain retirement income level. Existing proposals attempt to revise this part of the program in a variety of ways, including revising the benefit formula (usually to make it more progressive), changing features of the program (such as lowering the cost-of-living adjustment), raising the age of eligibility for normal and early retirement, or revising ancillary benefits (such as those for spouses). Most of these proposed changes are structured so as to leave current and near-term retirees unaffected. In addition, many would include an individual account element only for workers under a stated age, often around 50.

There are also ways to determine offsets to the individual accounts that would raise revenue for the defined benefit program. For example, Social Security could reclaim a portion of the individual account accumulations. This reclaiming, or so-called “claw-back,” could raise significant

“expectation gap” issues with individuals. These expectation gaps might be addressed by pooling the investment accounts and other measures.

Another feature of some proposals involves a guarantee of a certain benefit level. This guarantee could be provided in tandem with other benefit structure changes such that the worker would be guaranteed a minimum benefit. One approach would guarantee the current defined benefit. If the individual account provided less than the current benefit, then the system would ensure that benefits were provided to fill the gap. Such an arrangement might be desirable from a benefit adequacy perspective but would require safeguards against the government becoming an insurer of excessive risk-taking by individuals.

Clearly, the number of proposals and features make it difficult to sort out exactly what should be done. We need to study carefully what impacts any given proposal would have, not only on the overall cost of the system but also, very importantly, on individuals and families.

One basic feature in this regard concerns whether to make investment in individual accounts mandatory or voluntary. Insofar as individual accounts are intended to substitute for a portion of benefits provided under current law to make it easier to finance the program, most discussion has involved accounts that are mandatory. This is consistent with the stated goal of Social Security to ensure a measure of income protection in old age.

The notion of making the accounts voluntary has entered the debate through proposals that seek to maintain the existing benefit structure of the program. A voluntary account is an add-on approach that would supplement Social Security benefits and provide a measure of individual choice. But under such an approach the overall implications for retirement income would be uncertain. If the voluntary account was supplementary, then it might be difficult to determine whether a voluntary account added to total retirement income; it might merely substitute for other forms of saving.

Another potential result of creating a system of individual accounts would be the development of an infrastructure that would allow workers to build up additional savings to meet both income and health care cost needs in retirement. For example, workers not covered by a private pension could choose to contribute more to their individual accounts to augment their retirement savings. Workers could also contribute more to their accounts as part of any possible premium support plan to help pay health care costs

after they retire. The accounts could thereby contribute to overall retirement security, not just retirement income security.

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## **Options Are Available for Individual Account Design and Administration**

Not all proposals for individual accounts clearly delineate how these accounts would be administered, but those that do vary in three key areas: (1) who would manage the information and money flow needed to maintain a system of individual accounts, (2) how much choice and flexibility would individuals have over investment options and access to their accounts, and (3) what mechanisms would be used to pay out benefits upon retirement. Decisions in these areas would have a direct effect on system complexity and who would bear the costs and additional responsibilities of an individual account system as well as on the adequacy and certainty of retirement income for future retirees. Essentially, most of the decisions about the design of a system of individual accounts amount to trade-offs between individual choice and flexibility on the one hand and simplicity and standardization on the other. A full assessment of the implications of these trade-offs will be essential to the debate on whether and how to implement individual accounts. Table 1 summarizes some of the administrative functions that would accompany any system of individual accounts, the critical decisions associated with each function, and a partial list of the options that could be considered.

**Table 1: Snapshot of Design and Administration Issues**

<b>Administrative function</b>	<b>Critical decision/trade-off</b>	<b>Options to consider</b>
Managing the flow of information and money	Centralize or decentralize record-keeping	<ul style="list-style-type: none"> <li>Build on current Social Security tax and payroll reporting structure</li> <li>Build on employer-based 401(k) structure</li> <li>Build on individually controlled IRA structure</li> </ul>
Choosing investment options	Maximize individual choice or minimize risk	<ul style="list-style-type: none"> <li>Offer a small set of indexed funds</li> <li>Offer a broad range of investment options</li> <li>Combine the two options by requiring a minimum account balance before a broader range of options is available</li> </ul>
Paying retirement benefits	Maximize individual choice or ensure preservation of retirement benefits	<ul style="list-style-type: none"> <li>Require lifetime annuities</li> <li>Make annuities voluntary and permit lump-sum and gradual account withdrawals</li> <li>Combine the two options by requiring annuitization to ensure at least a minimum retirement income, with added flexibility for remainder of account</li> </ul>

**Managing the Flow of Information and Contributions**

When considering the design of a system of individual accounts, the first important decision involves account administration and management—that is, where and how the information on individuals’ contributions and the accompanying money flow would be recorded and managed. There are several ways in which this could be done, and the options span a continuum ranging from a centralized record-keeping system managed by the government to a completely decentralized system managed by various entities in the private sector. Each option offers advantages and challenges.

For example, a new system of individual accounts could build on the current tax collection and payroll reporting system of the government, with an agency such as the Social Security Administration assuming record-keeping responsibilities for individual accounts. Alternatively, some new centralized government clearinghouse could assume this responsibility. Managing this information centrally could help keep costs

down by taking advantage of economies of scale. For example, administrative costs for the federal Thrift Savings Plan, which centralizes both the record-keeping and investment functions, are low—averaging about \$17.00 per account in 1998. Centralizing these functions by building on the current system would not be without challenges, however. Under the current system, employers report earnings and contributions on an individual basis only once per year; it would take at least 7 to 22 months from the date an individual made a contribution to the date this information could be attributed to an individual's record. This time lag would likely make it necessary to pursue interim investment alternatives and to educate individuals on the nature and impact of the lag. Options to change the system to enable more timely recording and investing of contributions do exist, but they would require significant changes in the record-keeping systems of the government agencies, additional costs and reporting burdens for employers, or both.

If individual accounts were not centralized, they could be built upon a model similar to either the current 401(k) or Individual Retirement Account (IRA) systems.<sup>6</sup> While providing a wider range of alternatives for individuals, this approach would be accompanied by additional responsibilities and costs for employers, workers, or both. For example, under a 401(k) model, employers would bear the responsibility for creating an infrastructure to quickly deposit contributions and provide employees with links to and choices among investment managers. Building on an existing employer structure such as this would pose challenges and could prove costly to employers, however, because about 50 percent of the private sector workforce is not covered by an employer-provided retirement plan. Under an IRA approach, individual employees would bear the responsibility on their own to select an investment manager or managers and deposit their contributions. Under both of these decentralized options, the appropriate government oversight role would have to be weighed and considered.

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## Providing Flexibility in Choosing Investment Options

The next critical decision centers around how much choice or discretion individuals would have in selecting who would invest their funds and what the range of their investment options would be. Some proposals would allow unlimited investment choices, while others would offer a more limited range of choices. The primary consideration in deciding among the

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<sup>6</sup>A 401(k) pension plan is an employer-sponsored defined-contribution plan that allows participants to contribute, before taxes, a portion of their salary to a qualified retirement account. An IRA is a personal, tax-deferred retirement account; IRA assets can be invested in almost any kind of financial instrument.

proposals would be finding the right balance between individual choice and the related risks and costs to the individual and the government. These inherent trade-offs should be considered carefully.

Proposals that build upon a centralized system often assume that the government or some independent oversight entity would select a fund manager (or managers) through a competitive bidding process. Individuals would then select from among the investment options offered by a designated party. Some propose that these options be limited to a small set of passive or indexed funds similar to those offered under the federal Thrift Savings Plan, thus minimizing risk to the individual while providing some degree of choice. Such an approach would also serve to minimize administrative costs and program complexity. However, a centralized system of individual accounts also raises the risk that investment decisions could become politicized, depending on the extent of government's role in selecting the funds and fund managers and in other investment or fund allocation decisions. There are, however, ways in which these risks could be mitigated (e.g., employing master trust concepts or creating individual participation pools).

Other proposals would permit individuals more discretion in selecting their fund manager or managers, either through their employers or directly in the private market. Under this model, individuals would be able to select from among a much broader range of investment options, thus providing individuals with wider latitude to maximize their returns and enhance their retirement incomes. However, with that wider range of choices would come the attendant risk to individuals that their retirement income would not be adequate, as well as risk to the government that individuals with inadequate retirement income would turn to the government for support from other programs. In addition, a wider range of choices could also lead to added administrative complexity and higher administrative costs, which, if not offset by significantly higher returns, would further undermine individuals' retirement income.

Regardless of whether individuals were offered a wide or limited range of investment choices, there would likely be a need for enhanced public education, especially if participation in individual accounts was mandatory. Some educational effort or mechanism would be needed to provide individuals with information they could use to make informed investment decisions and to understand the consequences of these decisions. For example, individuals would need information on basic investment principles, the risks associated with available choices, and the

effect of choosing among alternatives offered for annuitizing or otherwise withdrawing or borrowing accumulations from the accounts. This would be especially important for individuals who are unfamiliar with making investment choices, for example, low-income and less well-educated individuals who may have limited investing experience. Moreover, the more choices offered, the more extensive the educational effort would need to be. If fewer investment choices were offered, the educational effort could be less costly. Who would provide such information to workers or who would bear the cost is not clear, but it might be possible to draw from experiences in the private pension system.

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## Preserving Account Resources for Retirement

The final design element centers around how the accumulated earnings in individual accounts would be preserved for retirement. Ensuring that retirement income is available for the life of the retiree is a fundamental goal of Social Security. Two important decisions relate to preservation. The first is whether to allow access to the accounts by workers before retirement (e.g., through borrowing). For example, most 401(k) pension plans allow participants to borrow against their pension accounts at relatively low interest rates. In prior work, we reported that relatively few plan participants—less than 8 percent—had one or more loans from their pension accounts at a specific point in time.<sup>7</sup> However, those plan participants who borrow from their pension accounts risk having substantially lower pension balances at retirement and, on average, may be less economically secure than nonborrowers. While some may argue that individuals should be allowed the freedom to optimize their lifetime income through borrowing from their accounts before retirement, the added complexity and potential diminution of retirement income need to be given serious consideration.

The second important decision is how much flexibility to permit workers when they retire and begin to draw on their accounts. Annuitization of individual accounts is one way to preserve benefits and ensure that benefits are available for the entire life of the retiree—no matter how long he or she lives. However, there are many questions to address in this area.

- Because these accounts would be the personal property of individuals, should annuities be required or should individuals have the option to withdraw their account balances in a lump sum or through gradual payments?

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<sup>7</sup>These issues are discussed in *401(k) Pension Plans: Loan Provisions Enhance Participation but May Affect Income Security for Some* (GAO/HEHS-98-5, Oct. 1, 1997).

- Could the mechanisms that are currently available for purchasing annuities accommodate the significant increase in demand?
- Would new structures and additional oversight be needed?
- How would the various annuity options compare with those of the current system, and would they provide for survivors' benefits?
- Should annuities offer protection from inflation?

Once again, this is not an all-or-nothing proposition. For example, it would be possible to require that individuals annuitize that portion of their accounts which would ensure a minimum retirement income and then provide more flexibility for any funds remaining.

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### Level of Administrative Costs Depends Upon System Design

Many people have expressed concerns about the administrative costs of individual accounts and how these costs would affect accumulations, especially for the small account holder. Each of the decisions discussed above could have a significant effect on the costs of managing and administering individual accounts, and it will be important to consider their effect on the preservation of retirement income. Administrative costs would depend upon the design choices that were made. The more flexibility allowed, the more services provided to the investor, and the more investment options provided, the higher the administrative costs would be. For example, offering investors the option of frequently shifting assets from one investment vehicle to another or offering a toll-free 1-800 number for a range of customer investment and education services could significantly increase administrative costs. Moreover, in addition to decisions that affect the level of administrative costs, other factors would need to be carefully considered, such as who would bear the costs and how they would be distributed among large and small accounts.

When considering whether and how to include a system of individual accounts as a part of Social Security reform, vital decisions on the optimal design, administrative structure, and implementation schedule will need to be made with great care. A system of accounts that spans the current 148 million workers and the 6.5 million employers, regardless of its design, would be significantly larger than any system we have in place today. Such a change would take time and careful deliberation over each of the options and trade-offs mentioned above. In addition, any implementation of individual accounts would need to allow for sufficient lead time to ensure success. The Social Security system is one of our nation's most important and visible programs. Therefore, we cannot afford to incur major implementation or administration problems. This is especially true

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because individual accounts would be highly visible to individuals and would represent “their money.”

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## Conclusions

The Congress faces significant challenges in restoring sustainable solvency to Social Security. We have a historic opportunity to meet these challenges because of the strength of our economy and future budget surpluses. We also have a historic responsibility—a fiduciary obligation, if you will—to leave our nation’s future generations a financially stable system. I believe it is possible to craft a solution that will protect the Social Security benefits of the nation’s current retirees while ensuring that the system will be there for future generations; and perhaps the answer does not lie solely in one approach or the other—defined benefit or defined contribution. Bridging the gap between these approaches is not beyond our ability. GAO and I stand ready to provide the information and analysis that can help the Congress meet this challenge in a way that can exceed the expectations of all generations of Americans.

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