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SOCIAL SECURITY REFORM

Considerations for Individual Account Design

GAO Accountability·Integrity·Reliability

Highlights

Highlights of GAO-05-847T, a testimony before the Subcommittee on Social Security, Committee on Ways and Means, House of Representatives

Why GAO Did This Study

Social Security forms the foundation for our retirement income system, providing critical benefits to millions of Americans. However, the Social Security program is facing significant future financial challenges as a result of profound demographic changes. A wide variety of proposals to reform the program are currently being discussed, including restructuring the program to incorporate individual accounts. When designing a system with individual accounts, there are many options and issues to consider. The choices that have to be made will affect not only participation in the accounts, but also the amount of savings accumulated in the accounts, and the benefit received from the individual accounts.

The Subcommittee asked GAO to discuss options for the administration of individual accounts, including the major design issues that are raised within the contribution, accumulation, and distribution phases of a retirement savings vehicle.

www.gao.gov/cgi-bin/getrpt?GAO-05-847T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Barbara D. Bovbjerg at (202) 512-7215 or bovbjergb@gao.gov.

What GAO Found

Because Social Security is so deeply woven into the fabric of our nation, any proposed reform should be considered as a package and with respect to all of the major elements of the Social security program (e.g., retirement, disability, and survivors). Individual accounts can be a part of that reform, and in fact, many proposals include individual accounts. However, any proposed reform must consider the program in its entirety, rather than one aspect alone. Likewise, an individual account system must address key design issues associated with the phases of a retirement savings vehicle.

Contribution phase: Designing the contributions for individual accounts requires making choices about the role that contributions play with respect to the current Social Security system. These choices include determining the size of the contribution rate, how the contributions are collected, whether the funds come from existing revenue sources, and whether participation is voluntary or not.

Accumulation phase: Once contributions have been made, the accumulation phase requires making decisions about what to do with the funds to make them grow. These decisions include how much choice individuals would have in selecting funds, who would invest their funds, and what the range of their investment choices would be. These decisions, in part, would determine the cost and complexity of the system and the degree of public education needed.

Distribution phase: Distributing the accumulated earnings in individual accounts needs to focus on how these funds would be preserved for retirement. This includes making choices about when individuals can gain access to their funds, how much money they receive, and in what form they receive the funds. Other considerations that arise include the tax treatment of distributions and whether there will be a guarantee of a specified level of benefits.

Overall, when designing individual accounts, it is important to keep in mind that more features tend to increase costs. For example, more investment choices can result in more administrative fees. Administering the accounts and educating the public about a system of individual accounts requires choices and trade-offs. However, any related administrative, management, and data systems must be developed and tested before the accounts become available to workers in order to maintain confidence in the system. Individual accounts could also be designed to include some progressive features, which would mirror the redistributive effects of the current Social Security program. However, it is important to distinguish between progressivity and benefit adequacy. Greater progressivity is not the same thing as greater adequacy and may result in less equity.