"SOCIAL SECURITY PRIVATIZATION: USING A TARGET BENEFIT APPROACH FOR INDIVIDUAL ACCOUNTS"

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Summary

This paper presents a unique approach to a totally privatized social security system. The main concept is a defined contribution account maintained by the government for each working individual. Individuals directly and affirmatively choose their targeted benefit at retirement, and then deposit the contributions likely to fund such target. The actual retirement benefit for each individual, however, is the actual accumulation of contributions and fund earnings, without any guarantees. Although the government will not supplement account balances upon retirement, it will make supplemental contributions to the accounts of indigent individuals, and others in limited circumstances, in the form of a welfare benefit subsidy. Each individual self-directs the investments of his or her account, as restricted by government regulations. Each working individual, on an annual basis, will reassess their personal financial situation and will determine the desired retirement benefit. Then, the individual will calculate the contribution likely to fund such target. The government will issue the actuarial factors to be used to calculate the level contribution, when amortized over the individual's future working years, needed to fund the difference between the present value of the targeted benefit over his or her current account accumulation. If the individual can afford the calculated contribution level, then an irrevocable election on a government-issued form will be made. However, if the individual can't afford the necessary contribution, then he or she must either find ways to meet the contribution requirement or lower the targeted benefit based on the level of contributions which can be made. This requirement for annual reassessment shifts control of retirement income away from the government and directly to the individual, which is similar to the way that individuals control the amount they electively defer to a cash or deferred arrangement (i.e., an American 401(k) plan). Generally, the government will only be responsible for the proper administration of the private account system and will not interfere with any individual's chosen target benefit, investment directions or elected contribution levels. However, certain indigent individuals, working individuals who have periods of non-employment, and certain individuals who, without fraud, have insufficient accumulations just prior to retirement, can affirmatively request a supplemental contribution from the government which will physically be deposited into such individual's account. Since a government supplemental contribution would represent a true welfare benefit subsidy, all "means testing" is shifted away from the government and is placed directly within the control of each individual. This paper gives the general outline for such a program and states some issues which would need to be debated and resolved by governments to implement such a program. The paper assumes that a social security system is comprised entirely of individual target benefit accounts and does not offer suggestions for a transition from an existing defined benefit-type program into a target benefit-type program.

"Privatizacion del Seguro Social"

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Resumen

Este papel presenta un enfoque extraordinario a un totalmente sisteme privatizado de seguro social. El concepto principal es una cuenta definda de contribución mantenida por el gobierno para cada individuo de trabajo. Los individuos escogen afirmativamente y directamente su beneficio señalado (targeted) en la jubilaciòn, y entoces deposita las contribuciones probables de financiar tan blanco (target). El benficio verdadero de la jubilaciòn para cada individuo, sin embargo, es la acumulaciòn verdadera de ganancias de contribuciones y fondos, sin cualquiera garantiza. Aunque el gobierno no suplementarà los saldos de cuenta sobre jubilaciòn, haràn contribuciones suplementarias a las cuentas de individuos indigentes, y de los otros en circunstancias limitadas, en la forma de un subsidio del beneficio del bienestar. Cada ser individual dirige las inversiones de su cuenta, cuando restringido por regulaciones de gobierno.Cada individuo de trabajo, en una base anual, revalorarà su situaciòn financiera personal y determinarà el beneficio deseado de la jubilaciòn. Entoneces, el individuo calcularà la contribuciòn probable de financiar tan blanco (target). El gobierno publicarà los factores de actuarial para ser usados para calcular la contribuciòn plana, cuando amortizado sobre los años que trabajara el individuo en el futuro, necesario para financiar la diferencia entre el valor actualizado del beneficio señalado sobre su acumulaciòn actual de cuenta. Si el individuo puede proporcionar el nivel calculado de contribuciòn, entonces una elecciòn irrevocable en una forma publicada del gobierno se hará. Sin embargo, si el individuo no puede proporcionar la contribución necesaria, entonces él o ella deben encontrar maneras del hallazgo para reunir el requisito de contribución o deben bajar el beneficio señalado (targeted) basado en el nivel de contribuciones que se pueden hacer. Este requisito para el revalúamiento anual cambia el control de ingresos de jubilación lejos del gobierno y directamente al individuo, que es semejante a la menera que individuos controlan la cantidad ellos prefieren diifere a un cambio o el arreglo diferido (en otras palabras, una americana 401(k) plan). Generalmente, el gobierno hace sólo ser responsable de la administración apropiada del sistema privado de cuenta y no intervendrá con qualquier individuos benficio escogido del blanco (target), las direcciones de la inversión ni niveles elegidos de contribución. Sin embargo, ciertos individuos indigentes, los individuos de trabajo que tienen los períodos de no empleo, y ciertos individuos que, sin el fraude, tiene las acumulaciones insuficientes apenas antes de la jubilación, puede solicitar afirmativamente una contribución suplemetaria del gobierno que será depositado fiscamente en la cuenta de tal individuos. Desde que una contribución suplementaria del gobierno representaría un subsidio verdadero del beneficio del bienestar, todo "prueba de medios" (means testing) se cambia lejos del gobierno y es colocado directamente dentro del control de cada individuo. Este papel da el resumen general para tal programa y expresa algunas revelaciones que necesitaría ser debatido y para ser resuelto por gobiernos para aplicar tal programa. El papel asume que un sistema social de la seguridad se comprende enteramente de cuentas individuales de beneficio del blanco (target) y no ofrece las sugerencias para una transsición de un programa de tipo beneficio, definido y existente en un blanco (target) el programa de tipo beneficio.

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This paper will provide a seemingly unique approach for privatized social security individual accounts. The author has read many different proposals for social security privatization, but has never come across a true target benefit approach. The target benefit approach explained herein, while likely to cause an unpredictable contribution level each year, should create a projected income replacement amount for each individual at retirement which can be relied on with some certainty. This approach will switch the responsibility for proper retirement planning from the government over to the individual. This paper is devoted solely to outlining general concepts for such a system and the author humbly leaves the finer details and application to be debated by other experts.

The general concept of this paper is a private account established for each individual with a personally selected benefit annuity targeted at retirement, a government-issued table of actuarial factors that each individual will use to determine the level contributions needed each year to reach that target, the individual's election to adequately fund the targeted amount, investment control by the individual for the accumulation of the account, and ultimately a retirement annuity based on the actual accumulation of the individual account at retirement. The responsibility of the government would be to effectively administer all accounts (or regulate those that do administer the accounts), to ensure proper communication and compliance, to regulate any and all competing investment companies methods, fees, sales techniques and advice, to supplement contributions for certain indigent individuals, and to set the rules for annuity distributions and taxation upon retirement.

Many governments of the world, including that of the United States, are looking at ways to either preserve existing social security systems or to establish systems for the first time. The author's intent is to provide the skeletal aspects of privatized individual accounts using a target benefit approach. This paper is not directed towards any specific nation; rather, it is a generic blue print addressing the issues and concerns that would need to be debated in depth. Any government interested in using this approach would necessarily need to properly integrate it into its existing socio-economic realities and national goals.

The first part of this paper will give a quick overview of the target benefit concept as it currently applies to qualified employer retirement plans in the United States. The second part of this paper will demonstrate how this target benefit approach can be modified to adequately fund privatized social security accounts. Finally, the third part of this paper will provide a summary of the target benefit approach. Throughout the paper, the author lists some of the issues that would need to be debated further by the social security experts of any particular nation that adopts such a social security system. The author cautions that specifically and purposely omitted from this paper is any discussion of the transition issues necessary to implement the program; rather, the paper simply looks at this target benefit approach as if it has already been fully implemented by the government. This paper represents the author's general thoughts on a target benefit approach based on his accumulated knowledge of the subject; therefore, it does not represent a research paper and there are no footnotes, endnotes or bibliographies.

I. Current target benefit approach for qualified employer retirement plans

Under the American regulatory scheme for private employer-sponsored retirement plans, a retirement plan is classified as either a defined contribution plan or a defined benefit plan. These two mutually exclusive categories of plans were based on the existing business practices in 1974 when the Employee Retirement Income Security Act (ERISA) was passed into law. ERISA section 3(34) states that a defined contribution plan is "a pension plan which provides for an individual account for each participant and for benefits based solely upon the amount contributed to the participant's account, and any [fund earnings] which may be allocated to such participant's account." Then, ERISA section 3(35) states that a defined benefit plan is generally any "pension plan other than" a defined contribution plan. It is important to classify a qualified retirement plan as either a defined benefit or a defined contribution plan since statutory rules, requirements and limits are only applicable to one or the other. There are some types of plans, however, which have been developed since the enactment of ERISA that have characteristics of each. One such plan is called a target benefit plan. Before discussing the attributes of a target benefit plan, however, a further differentiation of defined contribution and defined benefit plans is necessary.

A. Defined contribution plan

A defined contribution plan is one in which the contribution itself controls all taxation aspects and benefit accumulations. The benefit that an individual will receive upon retirement consists entirely of the accumulation of contributions (including benefits forfeited by short-service employees who were not fully vested in their accounts) and fund earnings. The benefit is usually paid out in a single lump sum. Each year, the participant receives a statement reconciling the preceding year's account balance with the current year's balance. Such statement seems to offer each participant an easy understanding of what benefits he or she has accumulated thus far; and such statements seemingly bestow on the participants a feeling of property rights in their retirement benefits. The author notes that unlike some other nations of the world, there is no constitutional right to retirement benefits in America; rather, participants in American private plans just have ERISA statutory rights which were developed through common law property and contract principles.

Thus, assuming level contributions throughout all working years, better-than-expected rates of return will yield a better-than-expected accumulation at retirement. Conversely, a lower-than-expected rate of return, including a market decline in the months immediately preceding retirement, will yield a lesser (and possibly inadequate) retirement fund. In a traditional defined contribution plan, the employer is either responsible for making a certain mandatory contribution for each employee who participates in the plan (i.e., a money purchase plan), or the employer is responsible for allocating a discretionary contribution among all accounts in any year in which a contribution is actually made (i.e., a profit sharing plan). As long as the employer sponsoring the plan invests the plan assets prudently and in the best interest of plan participants and beneficiaries, then the employer is not liable for losses to the accounts and the investment risk is thus shifted to the employee.

To further shift the investment risk, a plan like a 401(k) plan, where employees voluntarily elect to defer a portion of their salary (possibly with an employer match), can be structured so that each individual employee can self-direct the investments of his or her account. Although the employer must exercise reasonable and prudent care in selecting and monitoring the investment choices available to the employees, the entire investment risk will be shifted to the employees. American laws, however, prevent an employer from providing adequate investment education on an individual basis to employees. Therefore, an employee with little investment acumen has a good chance of investing to one of the extremes (i.e., much too conservative or much to aggressive) rather than commensurate with his or her personal financial situation and stage in life. This is unfortunate because defined contribution plans, by design, offer no benefit guarantees and such individuals are only entitled to whatever their accounts have accumulated to upon retirement.

B. Defined benefit plan

A defined benefit plan is entirely different because it is the promised benefit at retirement that controls all taxation aspects and contribution levels. The plan document defines the benefit the employee will receive at retirement, usually as an annuity starting at retirement and continuing for the life of the employee, the joint lives of an employee and his or her chosen beneficiary, a term certain, or any combination thereof. The employer accumulates assets in a common pool and simply pays liabilities as they come due to retired employees. By statutory mandate, every defined benefit plan must annually use an Enrolled Actuary to value the aggregate of future expected liabilities, compare them to accumulated assets, make assumptions about rates of return, rates of death, rates of new plan participation, expected salary increases, expected cost of living adjustments, and other contingent factors, and then to ultimately determine the contribution needed for that year which will properly fund the plan if all assumptions are met and all expected future contributions are deposited. Since an Enrolled Actuary makes a valuation every year, assumptions could be adjusted prospectively if they no longer represent the Enrolled Actuary's best estimate of future expectations. Each year, the participant receives a statement showing the deferred retirement annuity accrued to date and the deferred annuity promised by the plan if the employee continues working until reaching the normal retirement age of the plan. Although some unsophisticated individuals might not understand or appreciate the accumulation of his or her benefits as they are communicated through annual defined benefit plan statements, it is arguable that an individual promised a deferred annuity through a defined benefit plan can at least understand how much monthly income can be counted on during retirement (assuming that the individual remains employed with that employer until the targeted retirement age).

By pre-funding a defined benefit plan in such a manner under the guidance of an Enrolled Actuary, there should always be adequate assets in the common pool to pay the promised benefits for each individual as they come due. If assets earn a lower-than-expected rate of return, the Enrolled Actuary will calculate a higher-than-expected contribution that, under current American law, must be contributed by the employer. This means that the employer bears the investment risk and not the individual employee. However, by offering a defined benefit plan, the employer fulfills its paternalistic-type goals by providing an adequate and predictable retirement income as a reward to its valued employees. As a further guarantee to the American employees who are promised a defined benefit at retirement by their respective employers, the Pension Benefit Guaranty Corporation was established as a government-type insurer of defined benefit plans that are sponsored by employers who cease operations, experience financial hardships, or declare bankruptcy with underfunded plans.

C. Target benefit plan

A target benefit plan is a hybrid plan that brings together some advantages from both types of plans. Specifically, one advantage of a defined contribution plan (from the employee's point of view) is that he or she can track the accumulation of a personal account, thus having a satisfaction of ownership rights which is easily communicated and understood. One advantage of a defined benefit plan (again from an employee's point of view) is that the retirement income is known in advance so that proper planning may be made. On the other hand, one advantage of a defined contribution plan (from the employer's point of view) is that the investment risk is shifted to the employees themselves. One advantage of a defined benefit plan (again from the employer's point of view) is that their valued employees will be properly rewarded with adequate income during their retirement years.

Basically, a target benefit plan is deemed, under American law, as a defined contribution plan that has some attributes of a defined benefit plan. The plan document for a target benefit plan will define a targeted annuity benefit commencing at the plan's normal retirement date. The plan document will also contain actuarial factors necessary to determine the contribution that will theoretically fund each individual's respective benefit under an individual level premium funding method. The contribution for each employee will be the amortization over that employee's expected future working years of the present value of his or her target accumulation at retirement (which is referred to as the present value of future benefits) less his or her actual account accumulated to date (which is referred to as the theoretical reserve). Each year, the employer is required to deposit the total of contributions calculated for all plan participants (subject to arbitrary minimum and maximum contribution levels under American federal tax laws to control federal revenues). Such plan benefits are communicated to the individual through an annual benefit statement (since a Target Benefit plan is legally a defined contribution plan, the annual benefit statements reconcile the prior year's account to the current year account through employer contributions, forfeitures, and fund earnings).

However, since a target benefit plan is truly a defined contribution plan, the employee bears the investment risk and will only be entitled to the actual accumulation of his or her account at retirement. Although there is no annual actuarial valuation, the level contribution calculated for an individual for the current year and future working years will be greater if the account has previously earned a cumulative rate of return which is less-than-expected. In the end, although there is no guaranteed benefit at retirement like there would be under a traditional defined benefit plan, the employee at least has a better idea of what his or her accumulation at retirement will be under a hybrid Target enefit plan rather than a totally unknown accumulation under a traditional defined contribution plan. Again, all that ERISA requires from the American employer is the prudent and reasonable investment of plan assets, solely in the interest of the plan participants and beneficiaries, and subject to statutory prohibited transactions that prevent self-dealing by fiduciaries and parties in interest.

II. Suggested target benefit approach for individual social security accounts

The advantages of employer sponsored target benefit plans cannot be directly applied to social security private accounts by substituting the “government” for the private “employer.” This is mainly because Target Benefit plans exist in their current form based on federal tax laws and are funded by employer contributions taken directly from the employer’s general assets. The author opines, however, that with the modifications described below, the concept of targeted social security benefits could provide a practical method by which governments can offer privatized individual accounts that are likely to provide adequate retirement income. Further, if individuals are allowed to self-direct the investments of their accounts, then, with proper investment education, each individual will actually be in control of the level of their respective targeted accumulations at retirement. The government’s role will be to oversee the program and to shore up contributions only for certain individuals.

Currently, the United States, similar to other nations, uses a total defined benefit approach to social security retirement benefits. In America, the benefit (called the Primary Insurance Amount) for each working individual is based on a statutory formula applied to the individual’s actual career average compensation and the individual’s actual credited quarters of working and paying into the system. The American social security system is a true defined benefit scheme because there is a pool of assets from which all promised benefits are paid out as they become due. However, it is deemed a pay-as-you-go system because all liabilities paid in the current year to retirees, their survivors, or disabled individuals, come directly from contributions deposited into the system in the current year by working individuals. By statutory mandate, if an individual is employed by a private employer, then a percentage of that individual’s compensation (up to the Social Security Taxable Wage Base) is withheld from his or her paycheck and is deposited by the employer, along with a matching amount, into the Social Security system. If the individual is self-employed, then he or she pays both the employee and employer portions into the system.

The author opines that one major reason that social security systems, like the American one, are failing is because there is neither any pre-funding to accumulate the proper asset level nor is there an actuarial valuation comparing expected future liabilities to current reserves. Another reason for the expected failure is due to the fact that there will not be enough working individuals paying into the system in years that the so called baby-boomers are retired and are in pay status. However, most governments seem interested in experimenting with private defined contribution-type accounts rather than curing the existing defined benefit-type benefits with mandatory funding reserves. The author does not wish to add to the debate through this paper, but would rather describe how individual accounts can still look like defined benefit promises at retirement.

The author notes that the target benefit approach described herein is a theoretical program which represents the government's entire social security program (i.e., there is no defined benefit type minimums) and which has already been fully implemented (i.e., there is no transition from an existing defined benefit program over to privatized individual accounts).

A. Individual chooses his or her own target benefit upon retirement

The first place to start under this analysis is at the targeted benefit itself. Each working individual (which includes the self-employed) will choose, on an annual basis, the annuity he or she would like to receive at retirement. This choice will be based on factors such as the individual's reasonable income replacement ratio desired during retirement, the expected starting point of retirement, and whether he or she has a spouse who also has a private target benefit account. However, the key factor to this target benefit approach is the actual contribution he or she can afford to offset from his or her paycheck for deposit into the system in any given year. By allowing each individual to choose his or her targeted benefit based on personal goals and resources, all means-testing is totally shifted away from the government and over to the individual. The government will generally not need to review each individual's personal financial status and determine whether a welfare-type social security subsidy should be provided. As discussed below, the government will only do this upon formal request by the individual.

A little clarification is needed on the definition of retirement. Since all other aspects of this target benefit approach leave all retirement benefit decisions up to the individual, it is only fair to allow him or her to also choose the starting date of such retirement annuity income. Currently, governments are debating how to deal with phased-retirement where individuals reduce their hours in later working years, but still work several hours per week either to continue providing utility to society or simply for additional income. Allowing individuals to set their own annuity starting dates allows them to start receiving a certain level of retirement income as they reduce their work hours (and assumedly their salaries), allows them to continue making contributions into the private social security system during such transition period to amplify their retirement income in future years, and allows them to set their own schedule for retirement without government interference.

B. The individual's contribution election is made on an annual basis

The key to this target benefit approach is the contribution itself. The account, regardless of its label, acts as a defined contribution account. Therefore, the actual benefits any individual will receive upon retirement equals the accumulation of contributions and associated fund earnings. Only adequate contributions, which are wisely invested, can produce an appropriate retirement accumulation account for each respective individual. Under this target benefit account scheme, each individual makes an irrevocable election at the end of each year directing his or her employer on the exact amount that should be taken from his or her paycheck for deposit into his or her respective private social security account. A self-employed individual will make a similar election and will personally make deposits into the system.

Basically, each year, the government will issue a single table of actuarial factors that will be used to amortize over the future working years of an individual the difference between his or her elected target benefits and his or her current account balance. The government actuaries will annually update the factor to incorporate current life expectancies, cost of living projections, and expected rates of investment return. The author envisions a single comprehensive publication (or website), where each page represents a different number of expected years until the individual intends to start receiving his benefit in the form of an annuity (i.e., a targeted retirement date). For each such page, there will be a three-column table. Column 1 will list various monthly annuity amounts, column 2 will show the present value needed to fund such a monthly annuity (discounted by the number of expected years to retirement to the current date), and column 3 will list the associated actuarial factor necessary to fund such a target. The individual will select a target monthly annuity from column 1, its associated present value accumulation from column 2, and its associated actuarial funding factor from column 3. In order to calculate the total annual contribution necessary to properly fund his or her desired target, such individual would subtract his accumulated account from the present value accumulation amount and divide the balance by the actuarial funding factor.

For example, an individual who expects to retire in 12 years and who wants a monthly retirement income of $1,400 would flip through the comprehensive publication to the page indicating 12 years at the top, find an entry in column 1 equal to $1,400 (or an entry as close to it as possible), find the corresponding present value from column 2, subtract from that his or her account balance (as shown on his or her last annual account statement), and then divide the balance by the corresponding actuarial factor from column 3. This would represent that individual's contribution required for the next year.

If the individual can afford the contribution, then he or she so elects to pay the contribution. If the contribution is greater than can be afforded, then the individual must either choose a lower target benefit or formally request a supplemental government contribution. A self-employed individual will pay the full contribution required. If the individual is employed, however, then the individual pays one half of the irrevocably elected contribution amount and his or her employer must pay the other half of the required contribution. The government might need to set a maximum amount or percentage of salary that an employer will pay on behalf of any of its workers to eliminate abuses or disparate treatment among its similarly situated employees. Thus, an individual who elects a higher than expected contribution (due to a chosen target benefit which exceeds his or her financial picture, poor investment results in the account, or a voluntary decision to use some current discretionary funds to enhance his or her retirement account) does not automatically cause his or her employer to pay half of that amount.

The individual elects on a form (prepared by the government) indicating his or her desired target at retirement and an irrevocable election to have his employer withhold the appropriate contribution throughout the year (with the appropriate employer match). A self-employed individual will indicate the total contribution he or she will deposit (presumably on either a monthly or quarterly basis). This form will contain all government representations, warranties, acknowledgements and other relevant disclaimers as it sees fit. The government should define certain life-changing events which represent the only reasons that an election may be changed mid-year.

Under this system, since each individual is responsible for his or her own targeted retirement benefit, the average individual will accumulate an appropriate amount at retirement, and a wealthy individual can choose to put in less money into the system and get less out of it in the end. Since each individual must make an election each year, each individual can structure larger contributions in years where there are no other major expenses (such as predictable education, residence or health expenses). As discussed below, those individual's with inadequate target benefits (based on what they can afford to contribute) can get relief from the government.

The author notes that this election is similar to what many Americans currently do in their employer-sponsored 401(k) plans. An election to defer a percentage of a salary is made before each plan year, and such election is basically irrevocable for the upcoming year. The individual, in making the election, is forced to assess his or her financial means and determine how much current income is to be sacrificed to ensure adequate retirement income.

C. Individuals self-direct the investment of their accounts

The individuals are allowed to self-direct their target benefit accounts so that they are encouraged to invest wisely (because a better-than-expected return means less money taken from their paychecks during their working years while a less-than-expected return means greater annual contributions). The self-direction of an individual account is one of the major controversial aspects of privatization of social security for any government. All of the normal debate over the governmental regulation of private accounts, which is not exclusive to target benefit accounts, will necessarily continue. Although such debate is beyond the scope of this paper, the author offers the following questions which seem to predominate such discussions of private accounts.

Does the government only allow investment in certain pre-approved investment vehicles or does the government just regulate the private investment companies who attract clients through competition and better investment strategies? Does the government provide investment education or does it defer such education to the investment companies? Does the government put caps on fees that can be charged from the accounts? Does the government restrict certain investment options (such as foreign entities, ultra-risky investments, and morally-questionable products) and, if so, is such investment restriction placed on the investment company or the individual? Does the government establish an insurance program which protects invested accounts from fraud, theft and embezzlement? Does the government assume responsibility for the proper maintenance and communication of each individual account, or is that responsibility borne by the investment companies?

The answers to these questions will form the basis for cost analyses, structural safeguards, and politically divisive debate. Any government that privatizes accounts, whether through this target benefit approach or by an alternate defined contribution method, must grapple with these and other questions before the final program can be implemented.

D. Government assistance in supplementing a contribution

Up until now, the target benefit approach shows that the individual chooses his or her desired target benefit at retirement, irrevocably elects the appropriate contribution to be withheld from his or paycheck for the following year, and has investment control over the account. An average individual will thus properly fund the targeted benefit and have adequate retirement income through the social security program. Additionally, a wealthy individual who has enough other assets to use for retirement will not need to set too high of a target, will contribute less into the social security system, and thus can potentially spend the unused social security contributions directly into the economy. What about indigent individuals who simply cannot afford the necessary contribution for any given year? What about individuals who are temporarily removed from the work force (such as parents on maternity or paternity leave, unemployed or disabled workers, or citizens who work abroad for a certain period of time)? What about individuals who are within 10 years of a standardized retirement age but their accounts have been invested or funded so poorly that the desired target cannot be accumulated by the level of contribution they can afford to pay? The government can help all of these types of individuals through a supplemental contribution for any given year.

This supplemental contribution, however, must be very regulated and must treat all similarly situated individuals in a similar manner. This aspect of the target benefit approach has the greatest chance of being abused by certain individuals and of being corrupted by certain government officials. The procedures set forth below should just be the starting point, and governments would be encouraged to amplify the list of safe-guards as they see fit.

Each year, as the government delivers an irrevocable contribution election form to working individuals, it will also deliver a supplemental contribution request form. Such request form will allow an individual to disclose what the required contribution would be for his or her desired target benefit at retirement, the portion of the contribution that they can actually afford, and a request for the government to physically deposit the deficit. The form will be signed under the penalty of perjury and the government will retain the right to investigate the truthfulness of each request. If the targeted benefit and the amount of contribution that such individual can afford is deemed appropriate, then the government provides a welfare benefit to such individual in the form of an actual supplemental contribution (as opposed to a tax credit or other form of welfare aid). Once the government deposits such supplemental contribution into the requesting individual's personal account, the government must not thereafter interfere with that individual or his or her account in any manner unless such individual requests another supplemental contribution in a subsequent year. Similarly, the government must maintain a non-interference policy for all accounts for which they do not supplement. The integrity of the system relies on individuals taking control of their respective retirement incomes due to personal goals, finances and sacrifices, and voluntarily requesting help from the government only when really needed.

The government can make similar supplemental contributions to workers who have an existing account but who can't make a current contributions during their periods of non-employment. Such individuals can be returning students, temporarily unemployed workers, temporarily disabled workers, parents on family medical leaves of absences, voluntary military personnel out on approved military leave, or domestic citizens temporarily working abroad who are not covered by their host country's social security system for the time that they are there. In such cases, the government can either cover the full contributions during those years, or the government can make supplemental contributions in future years when the individual returns to work. and can afford to make some contributions but needs governmental assistance for the deficit.

Finally, the government can make similar supplemental contributions to individuals who are within 10 years of a standardized retirement age whose target benefit they can afford to fund over the next few years will truly be inadequate for them to live on. Here, such individual would be expected to disclose all other assets available to him or her during retirement and an explanation as to why their private account has been inadequately funded. After an investigation, the government can supplement only those individuals who will truly suffer without such assistance and whose accounts are not insufficient due to fraud. The disclosure and investigation would likely eliminate potential abuses by individuals who either purposely underfund their accounts or who purposely invest unwisely and then expect the government to bail them out in the final years before retirement.

As indicated, this target benefit approach totally eliminates any aspect of welfare or wealth distribution directly from the social security system. Supplemental contributions represent a single deposit (or a series of deposits) that allow certain individuals to accumulate an account for use during retirement in the same manner and with the same responsibilities as all other working individuals have. Even those workers who have periods on non-employment will use the same accounts during retirement. The government can then set up a non-social security welfare program for any individual who, during retirement, does not have adequate income, irrespective of whether there is an improperly funded private target benefit account or not.

E. The retirement benefit

The target benefit account should work best by providing an annuity at retirement for the individual rather than a lump sum. The individual chooses the monthly retirement income desired. For funding purposes only, the monthly annuity is converted into a present value amount so that it can be compared with the current accumulation. The normal form of benefit should be a single life annuity based on the individual's life expectancy. The government can establish tax incentives to encourage annuitization.

Unlike an annuity from an insurance company or from a private-employer plan, however, if the individual lives longer than expected, then the private account will be depleted and the individual might need to seek government assistance through a non-social security welfare system during the very final years of retirement. However, if the government actuaries update the actuarial factors on an annual basis, then the average individual should have adequate retirement income for the remainder of his life.

The real controversy lies not in what happens if the individual outlives his or her life expectancy, but rather in what happens if the individual dies earlier than expected. The two choices are: since these are private accounts, then any balance remaining upon the individual's death becomes estate assets and will be transferred to survivors and other beneficiaries; or, since this is a government program, then any remaining balance upon an individual's death is forfeited to the government as an actuarial gain and is used to supplement those individuals who outlive their annuitizations. The author sees this as the most crucial debate over privatized accounts.

So far, this paper has described accumulation accounts to be used during retirement. Many social security systems also offer survivor benefits upon the death of the working individual. If the private accounts are not forfeited upon the individual's death, then the problem of the survivor's benefit is easily solved because each individual has a property right in his individual account and the balance upon his or her death can be transferred as all other personal assets. If the private accounts are forfeited upon the individual's death, however, then the government must come up with an alternate means of providing survivor benefits.

In addition to survivor benefits, many social security systems offer disability benefits to the individual worker. The author, however, does not readily see how the private accounts can be used by the individual while in a period of disability and then be used upon retirement. An ancillary program for providing disability benefits will likely need to be developed by the government. Under this target benefit approach, retirement is merely an arbitrary annuity starting date chosen by each individual, but if the assets are used for non-retirement purposes, then safeguards will need to be put in place to preserve as much of the private account as possible for actual retirement..

The government might find it in its own best interest to set a threshold age before which no one has access to any portion of their account (such as age 55). However, governments might want to establish procedures where funds may be withdrawn prematurely, as a loan, for certain emergencies. Additionally, governments might want to set up procedures for allowing additional withdrawals from accounts during the retirement years for certain other types of emergencies.

III. Conclusion

This paper is intended to outline a target benefit approach to privatizing social security systems. It is entirely void of any of the mechanical rules for a transition from a defined benefit system into such a defined contribution approach. Similarly omitted from this paper are any comments regarding the socio-economic affects of using this type of scheme. This paper is intended to be the starting point for discussion for any government which is contemplating and debating whether a privatized social security system would be appropriate based on its respective tax structure, goals for retirement income levels for its citizens, economic restraints and legislative formalities necessary to implement such a program. The author humbly leaves such debate to each respective government commission, public policy think tanks, concerned citizens and advocacy groups.

To summarize, under this social security approach, each working individual would have a private account maintained (or regulated) by the government. The accumulation of the account at the individual's chosen annuity starting date (i.e., retirement) would be annuitized to provide retirement income during the individual's life. On an annual basis, each working individual will choose a target benefit desired at retirement and will irrevocably elect to deposit the following year's contribution that is necessary to properly fund such desired target. The government will produce factors to be used to calculate the contribution as the level amortization over the individual's future working years of the difference between the present value of the desired target and his or her current account accumulation. The individual will be allowed to self-direct the investment of such contributions in accordance with governmentally approved procedures. In any year that a working individual needs assistance from the government to supplement his or her contribution, such individual must affirmatively request a supplemental contribution under penalty of perjury and after disclosing specific personal financial data supporting the need for such request. Individuals who have periods of non-employment can similarly request supplemental contributions from the government. To eliminate potential abuse, the government will only provide such supplemental contributions to individuals who are within 10 years of a standard retirement age and who cannot properly fund an appropriate target benefit during their remaining working years.

This target benefit approach shifts all means-testing away from the government and places it directly with its working citizens. While the government will be affirmatively requested to supplement certain annual contribution levels, such contributions will be in the form of a welfare subsidy. This approach ultimately represents a program design in which an individual's revenue and utility directly correlates to his or her retirement income, rather than a program which is designed to have all funding by current workers go to the government for redistribution to current retirees.