A model for investing Social Security funds in stocks

By Kerry Pechter *Thu, Nov 21, 2013*

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Some observers have suggested investing a portion of Social Security trust fund assets in equities. An existing retirement plan for railroad workers offers a model for how that might be done, according to a new brief from the Center for Retirement Research at Boston College.

The Railroad Retirement program, which holds $23 billion in assets, bears some similarity to Social Security. An act of Congress in 2001 allowed the railroad fund to start investing in equities, and the fund has encountered and overcome some significant risks associated with equity management since then.

The Social Security trust, which currently holds $2.7 trillion in U.S. Treasury obligations, would need to accomplish two things to follow the Railroad Fund's lead, according to the brief, written by CRR research economist Steven A. Sass.

The Railroad Fund implemented an automatic mechanism to respond to financial shocks. It adjusts the amount of payroll taxes dedicated to the plan based on whether the pension fund's total assets are up or down. Social Security could create a similar mechanism, according to the brief.

"The Railroad Retirement ratchet adjusts tax rates based on the ratio of Trust Fund assets to annual benefit outlays, averaged over the previous 10 years. The adjustments are designed to keep that ratio within a target band of four to six times outlays. The ratchet raises taxes should the ratio fall below four, and cuts taxes should it rise above six. These adjustments are based on the slow-moving 10-year average of the ratio of assets to outlays because both management and labor sought to avoid sharp year-to-year changes in tax rates," the brief said.

To limit politically motivated meddling in their fund, the railroads established a trust independent of Congress, the National Railroad Retirement Investment Trust. Social Security could do something similar. To limit manager risk, the Social Security trust could "specify the share of Social Security assets to be invested in equities, say 40%, and then direct those assets to be invested in a broad market index, such as the Russell 3000 or the Wilshire 5000," Sass wrote.