Could Uncle Sam Guarantee a 5% Return for Life?

By Editor Test *Sun, Jun 7, 2009*

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The brief, entitled "What Does It Cost to Guarantee Returns?" concludes that the government, with its access to cheap capital and its multi-generational investment horizon, could guarantee a return of between 4% and 6% at no net cost to taxpayers.

The report was written by **Alicia H. Munnell**, director of the CRR and the Peter F. Drucker Professor of Management Science at Boston College's Carroll School of Management, and **Alex Golub-Sass**, **Richard A. Kopcke**, and **Anthony Webb**.

The study arose from concerns that many Baby Boomers will be financially unprepared for retirement. Given the increase in longevity, the increase in the age of full eligibility for Social Security, the relatively low participation rate in 401(k) plans and the low balances in many accounts, the authors postulated that a "new tier of retirement accounts" may be necessary to help Americans save for old age.

To be truly valuable, the new tier of accounts would have to guarantee that would provide smooth, attractive returns, the authors said. They then set out to determine how much a guarantee would have cost under historical conditions and how much it might cost in the future.

They concluded that private industry wasn't suited to the challenge. "Relying on the private sector for even low levels of guarantees raises issues relating to the continuity of the insurer and the availability of a natural hedge. Given the recent demise of **Bear Stearns** and **Lehman Brothers** and the plight of **AIG**, individuals would have no confidence that the firm offering the guarantee would be there for the payoff 40 years down the road.

And private sector firms would have no natural hedge to insure against the possibility of having to cover the guarantee, since very few counterparties exist that would gain from a sharp economic downturn. Thus, the government becomes the only realistic source of guarantees."

The authors' calculations showed that if the government put a floor of 4% under returns and kept the returns in excess of 6%, it could afford to provide the guarantee at no added cost to taxpayers. Alternately, the data showed that the government could guarantee a minimum return of 2%, with no cap, for a premium equal to about 13% of contributions to the program.