



# Social Security Choice

## ***SOCIAL SECURITY THIS WEEK***

A WEEKLY NEWSLETTER ON SOCIAL SECURITY REFORM

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### ***Johnson Reintroduces Bill for 6.2% Personal Retirement Accounts***

On February 2, Rep. Sam Johnson (R-TX) reintroduced legislation in the House based on the [Cato Institute's 6.2% Solution](#). In reintroducing the Individual Social Security Investment Program Act, Johnson said, "Let's get this straight. Social Security will be there for current and near-retirees. For every American who is 55 or older, do not let anyone mislead you. For you, the Social Security system will not change in any way. You deserve the peace of mind of knowing you will get full benefits for your entire retirement. We need to strengthen Social Security today so tomorrow's retirees can receive the same benefits current seniors enjoy. Social Security reform is all about generational fairness."

In the last Congress, Johnson's proposal gained the most co-sponsors of any Social Security reform legislation. The Individual Social Security Investment Program Act of 2005, H.R. 530 allows younger generations to invest the Social Security taxes they pay (6.2% of salary) in a personal retirement account. The employer's share of the tax would be sent to the current Social Security system to fund continuing retiree and near-retiree benefits for those currently 55 and older, transition costs and the disability and survivors program. The bill does not impact current or near retirees.

"Social Security was built for a different America," Johnson said. Created in 1935, the pay-as-you-go system worked well. Current taxes covered current benefits. The average working male lived to age 60, when the retirement age was 65. At the time, 42 people supported one retiree.

In 1950, 16 workers supported one retiree. Now 3.3 workers support one retiree. That number is on a downward path to two. By 2018, current taxes will no longer cover current benefits. "Think taxes are too high now? Imagine what they will be in the future if we don't make the necessary changes in the present," asked Johnson.

"To make matters worse, there is a horrible rate of return and Americans deserve better. Young people entering the workforce today will earn almost no interest on their lifetime of hard work. That's right. No interest. And even workers in their forties will receive a paltry two percent. If your financial advisor earned you zero percent on your investment, you'd fire him," said Johnson.

“There has got to be a better way. It’s time to give the American people a say in how their retirement money is invested and an opportunity to do better,” said Johnson.

“You should have the right, if you wish, to invest YOUR Social Security taxes in safe, diversified funds like the program federal employees and Members of Congress have because the return has been proven to be better than with any government fund. If it’s good enough for Congress, surely it’s good enough for the American people.

“I just ask people to focus on the facts, and then make up their own mind. When it comes to financial literacy and Social Security, the more you know, the better off we’ll be,” concluded Johnson.

### ***House Conservatives to Push for Bigger Accounts***

David Kirkpatrick and Carl Hulse, [writing in the \*New York Times\*](#), note that many House Republicans are unsatisfied with the president’s proposal to redirect only 4 percent of payroll taxes to personal retirement accounts. Several members of the House Republican Study Committee, which met in Baltimore for a retreat last week, called for larger accounts, such as those proposed by the Cato Institute and the supporters of the Ryan-Sununu bill. According to the article, excerpts of which follow, the group also pledged its opposition to tax increases to generate revenue for the growing number of retirees.

“Conservatives in the House of Representatives put down their marker in the battle over changing Social Security on Friday, calling for larger individual accounts than President Bush has proposed and promising to fight any tax increases to pay for the benefits to the growing number of retirees.

“At a retreat here attended by more than 50 representatives in the conservative House Republican Study Committee, its chairman, Representative Mike Pence of Indiana said the members’ objections to new or increased taxes to pay for the president’s plan was deafening. Mr. Pence said the group also called for allowing workers to set aside 6 percent, instead of the president’s proposed 4 percent, of their wages, roughly all of their Social Security payroll tax, for individual accounts....

“Beyond endorsing those proposals, they said they wanted to use the debate as a wedge to achieve their long-held goal of shrinking the size of government.

“‘So seldom it seems to me do these windows of opportunity to really recast government come along,’ Representative Bob Beauprez, Republican of Colorado, said.

“Several members noted that Congress has for decades helped finance general spending by borrowing from the surplus in the Social Security trust fund, money generated by revenues from workers’ payroll taxes that exceeded the cost of paying retirees’ benefits.

“‘Government took the money out of the Social Security surplus,’ Representative Jeb Hensarling, Republican of Texas, said. ‘The government ought to give the money back, and the way to do that is to moderate the growth of government. We all hate the deficit. But the deficit is the symptom. Spending is the disease.’

“As Senator Tom Coburn, Republican of Oklahoma, said just after the president’s State of the Union address: ‘I am not going to be able to put my finger in the dike and

stop this place from spending the money. I want personal accounts because I want to take the money away from here so people can't have it.'

### ***Democratic Leadership Reportedly Threatens Bipartisan Reform Efforts***

According to Rep. Paul Ryan, who has sponsored personal account legislation to reform Social Security, efforts to build bipartisan support for PRAs are being systematically thwarted by the Democratic leadership. From an item in the *National Journal's* CongressDaily, "Rep. Paul Ryan of Wisconsin, who spoke at a Cato Institute event, said fear of retribution from their own leadership was scaring Democrats away from his proposal."

"I have been floating it to Democrats,' said Ryan. 'Each of them replied to me, "I like what you're doing, I like this bill, I think it's the right way to go, but my party leadership will break my back. The retribution they are promising against us is as great as I've ever seen, and I can't do it.'"

Rep. Ryan spoke at Cato's recent two-day conference on a panel entitled "On the Hill: Proposals for Individual Accounts," along with Sen. Lindsey Graham, Rep. Sam Johnson, Rep. Jim Kolbe, Sen. Jim DeMint, and Rep. Clay Shaw. To hear this and other panels from the conference, click [here](#).

### ***Tim Penny: Straw-Man Arguments Prevent Honest Discussion***

Writing this week [in the Washington Times](#), former Democratic congressman Tim Penny—long a leader on the topic of Social Security reform—accuses opponents of personal accounts of wasting time by creating 'straw man' arguments that divert energy and attention away from the true problems facing the Social Security system, which are numerous and increasingly urgent. In the following excerpt, Penny identifies some of the more popular diversionary straw men that are trumpeted by PRA opponents.

"Given that both the president and his detractors agree Social Security problems are on the horizon, you would think they would agree to put all reform options on the table in order to find a solution. Finding a reasonable solution, however, requires that options be fairly and honestly debated. Here is where the 'straw men' enter the picture.

"First, opponents insist reformers are out to 'privatize' Social Security. They know 'privatize' is a scary word, so they use it a lot. The 'privatization' allegation is designed to conjure images of a program in which the federal government backs out of its role in providing a safety net for retirees. But no such thing is proposed by reformers.

"Under the proposals advocated by the president and others, Social Security would remain a government program. Payroll taxes would continue to be collected by the government and used exclusively to provide retirement income. A safety net of benefits would still be guaranteed under the traditional Social Security system. Finally, only a portion of payroll taxes would be invested in personal accounts—and those would likely be managed by the government in a fashion similar to the Thrift Savings Plan (TSP) now available to federal workers (including members of Congress). No one would suggest the TSP is a 'privatized' retirement plan because it is not.

“Second, opponents claim reformers want to place workers at risk of the stock market. Again that is not borne out by the facts. Because most reform plans are fashioned after the Federal Thrift Savings Plan, it should be clear that reformers are aware of the need to manage the risk associated with personal accounts. Under the TSP, there are a limited number of investment options (currently only five). The TSP offers mutual fund investments—broad based investment funds, either all bonds, all stocks or a little of each. None of these funds is heavily invested in any one company or any industry sector.

“Third, opponents argue that reform is a Wall Street driven idea. Not so. Having worked on this issue for nearly a decade, I can report most Wall Street firms have been reluctant to engage in the debate. In fact, some investment firms are leery of personal accounts. These firms are comfortable with traditional Social Security as a bedrock upon which additional retirement investments can be built.

“Frankly, the demand for reform is driven mostly by younger workers. Polls consistently show those under 50 years of age favor reform and personal accounts by a margin of 2 to 1 or even 3 to 1. Younger Americans have come to believe traditional Social Security is a Ponzi scheme in which they will end up paying a lot more and getting a lot less. They want the security of investing some of their payroll taxes in a fund they own and control.

“Finally, opponents assert reformers want to ‘destroy’ Social Security. Again, not true. Reform advocates simply do not want to wait until the crisis is upon us to fix Social Security.

“Because we waited until the crisis hit before we took action, higher taxes and benefit cuts were all that could be done in 1983 (the last time we bailed out the system).

“The pending problems with the current system are there for all to see. Clearly, doing nothing is not an option.

“Let’s not repeat the mistake of waiting too long. It is time to earnestly begin the debate about strengthening Social Security for the future. Setting up ‘straw men’ simply delays an honest debate—and moves us closer to a real crisis.”

## ***New York Times Misleads Readers on Chilean Personal Accounts***

On January 27, the *New York Times* ran [an article by Larry Rohter](#) that indicated that the Chilean private pension system was not as successful as proponents of personal accounts claimed. However, Rohter’s article contains numerous factual errors and inaccuracies while leaving out quite a bit of pertinent information. Overall, the article painted an incomplete—and exceptionally misleading—picture of the Chilean system.

Here are some corrections on the information presented in the article.

- Rohter claims that the first generation dependent on the new system are now retiring and finding their accounts are insufficient to fund their retirements. This is untrue. Those currently retiring are *not* the first generation to be dependent on the new system. The workers retiring now have accrued only 24 or 25 years worth

of contributions in their accounts. The first generation to be fully dependant on the new system will be those retiring in 2020-2025. Only then can success or failure be measured.

- Dagoberto Saez, the example used in the *Times* article, contributed to his retirement savings for only 24 years out of a 40 year period. Even having contributed for so few years, he currently receives 1/3 of his pre-retirement income. That is a replacement rate of 33% of his *last wage*, not his average career wage.
- Rohter states that reformers expected the system to be self-sustaining by now. No one ever suggested the system would be self-sustaining by now; there are still far many people receiving the artificially high (and unsustainable) benefits from the old system.
- The basic safety net features of the new system—including a guaranteed minimum pension and pension assistance—will prevent the program from ever being entirely self-sustaining. This should come as no surprise. Benefits from a government transfer program—such as a guaranteed minimum benefit—can never be truly self-sustaining.
- The article claims that "billions of dollars" are spent on the social safety net for those whose accounts cannot sustain them in retirement. The real number is only \$70 million dollars of money spent in the Minimum Pension Guarantee (MPG), and, as Estelle James points out in her Feb 13th article in the Washington Post, only 4% of retirees of the PRAs system have had the need to receive that MPG.
- Chile's rigid labor laws, which keep unemployment high, also contribute to the amount necessary to adequately fund the safety net.
- The *Times* claims that returns on the private accounts are "burdened with hidden fees that may have soaked up as much as a third of their original investment." This is untrue on two counts:
  - That percentage includes life and disability insurance payments. The management fees are actually estimated at .65% of assets under management (AUM), the relevant measure for a pre-funded system. This is lower than the average fee for mutual fund management in the United States.
  - The Chilean AFP system is extremely transparent. All fees are published in the major newspapers; changes in fees must be advertised months in advance.
- Rohter reports that more than \$66 billion has been paid by the government towards benefits since privatization began. That \$66 billion has largely been directed at paying off the promises to people who stayed in the old system.

- The actual transition cost to the government of the AFPs is not 5 to 6 percent of GDP, as was implied in the *Times*; it was closer to 2%. The 5–6% estimate includes not just the diverting of money from the old system, but also legislated increases in social safety net spending, a change in the way revenue streams to the pension system are accounted for, the permanent cash deficit in police and military pensions, and the creation of new pension systems for special groups.

For more on the Chilean pension model, please see José Piñera’s recent op-ed, “[Retiring in Chile](#),” which first appeared in the *New York Times* on December 1st, 2004, as well as L. Jacobo Rodríguez’s “[Chile's Private Pension System at 18: Its Current State and Future Challenges](#),” Cato Social Security Paper No. 17.

### ***Cato Scholar on the Trust Fund Myth***

In an op-ed released nationally this week, Cato research assistant Brooke Oberwetter writes that the enduring myth of the trust fund stifles honest discussion of various proposals to reform Social Security. Though the trust fund does contain bonds that represent cash owed to the Social Security system, Oberwetter writes, cashing those bonds to pay for benefits will cost the federal government more than \$5 trillion in the not-too-distant future. The text of the op-ed follows.

“Every so often, a letter to the editor in a small local paper will catch my eye: ‘George W. Bush plans to plunder the Social Security trust fund with his privatization scheme that will throw seniors into poverty and benefit his fancy-pants friends on Wall Street.’

“That’s a paraphrase, but it captures the tone and tenor of the rants. Sometimes there is a tale of woe in the letter about a parent or grandparent whose retirement savings were ravaged by the Great Depression. If only there had been a Social Security trust fund for their relatives, letter writers complain, things would have worked out.

“But the reality is that just as there was no trust fund then, there is no trust fund now. Many people naively believe the government is just sitting on their payroll taxes, waiting for the workers to retire. Columnists and editorial boards of respectable newspapers pen columns that continue to inspire belief in the myth that the trust fund contains real assets.

“Social Security benefits are paid from current payroll tax revenues—so today’s workers finance the retirement benefits of current retirees. Since the system’s inception, there have always been more workers paying taxes than retirees receiving benefits. When the payroll tax was raised in 1983, sizeable yearly surpluses in the system began accruing, which created the illusion of a trust fund. But by law, the surpluses are not saved.

“It seems logical that the government would stow surplus money away for the future. After all, if there were enough workers to generate the surpluses, it shouldn’t have taken much foresight to realize that someday those workers would themselves be making claims against the system.

“But foresight is not something for which governments are typically regarded. By law, the government must use the surplus cash flow to buy treasury bonds from itself. The proceeds from the sale are mixed in with general revenues, spent on everything from highway maintenance to faith-based initiatives to sea lion recovery in Alaska. The money that hapless letter-to-the-editor writers are so concerned about being pillaged by personal accounts is actually pillaged every year already.

“The treasury bonds are what constitute the ‘trust fund.’ These bonds are essentially IOUs, promises that the government will pay the system back. Right now, the government owes the system \$1.7 trillion, and the number grows every year by roughly \$200 billion, plus interest.

“In less than 15 years, as the baby boomers begin retiring en masse, the bonds will start to come due. The dwindling worker to retiree ratio is set to cause Social Security to begin spending more in benefits than it takes in from tax revenues beginning in 2018. And that will be problematic.

“If left unchanged, the system will start cashing in those treasury bonds in just 13 years, putting enormous pressure on already strained budgets. It will continue to draw money from the general revenue until the government’s obligations to the trust fund are met, sometime between 2042 and 2052. It’s likely that income taxes will be raised during that time to make up for the ever-growing annual shortfalls of Social Security.

“Once the treasury’s obligations to the trust fund have been met, the system will only be able to pay 73 percent of projected benefits with its annual income. The people whose benefits will be slashed when that date arrives would be the same people who endured twenty some-odd years of higher income taxes to pay off the government’s debts.

“More likely though, the payroll tax will increase as benefits are gradually reduced, making Social Security a pretty terrible investment, with negative returns to most participants.

“Workers will pay more in taxes for less in benefits. Some experts suggest that today’s college graduates will be paying \$1 in every \$6 they earn to Social Security by the time they retire. That is the legacy that the folks writing horror stories about the Great Depression to the local newspapers would leave for their children and grandchildren.

“Today’s young workers can learn a valuable lesson from those who survived the Depression—if the choice for retirement savings is between Social Security and a shoebox full of money under the bed, money under the bed isn’t a bad way to go.”

### ***Urban Institute Scholar: Many Social Security Problems Must be Addressed***

In a commentary [appearing in USA Today](#), Eugene Steuerle of the Urban Institute suggests that many of the problems with Social Security are being overlooked in the debate over personal accounts. Steuerle makes several excellent points about

Social Security and its shortcomings as a piece of social policy apart from its funding problems. An excerpt of his comments follows.

“[T]he real problem is that Social Security was designed decades ago for the needs of a different age. Here’s what we should be talking about before we broach private accounts:

- **Inequality.** Today, abandoned spouses with children, single or divorced people, and two-earner couples—rarer birds in the 1940s—all get short shrift. But a spouse who doesn’t work, doesn’t raise children and doesn’t pay any taxes can receive hundreds of thousands of dollars more in benefits than an abandoned mother who works, raises children and pays taxes.

Similarly, a two-earner couple in which each person makes \$15,000 a year is slated to get \$100,000 less in lifetime benefits than a one-earner couple making the same \$30,000 with the same tax bill.

- **Life expectancy.** Increasing longevity poses new issues, too. Typical couples now get benefits for 25 years, and less than half of all payments go to them in their last decade of life, when most will have lower incomes, more health problems and less likelihood of working. Social Security is morphing into a retirement system for the middle-aged just as the boomer bulge nears retirement.

### **Spreading the pain**

- **Poverty.** Though Social Security benefits are rising, the extra funds do little to conquer poverty among older Americans. The solution isn’t necessarily spending more, but spending wisely. Yet the current debate largely skirts the issue of poverty.

- **Disability, health costs.** Another mistake is not reforming disability insurance and Medicare at the same time as Social Security. For instance, reducing Social Security benefits could prompt individuals nearing retirement to try to qualify for potentially higher disability benefits. Similarly, part of Medicare’s rising costs for doctors and drugs is taken from pensioners’ Social Security checks.

- **Savings.** Finally, Social Security reform should be part of a larger conversation about how to increase and protect private saving for retirement. Today, the total amount of personal savings annually is less than government tax subsidies for private pensions. And the Pension Benefits Guaranty Corp., which takes over some pension plans when corporations can’t honor their promises to former employees, is facing a crisis like the one that menaced the savings-and-loan industry in the mid-1980s and led to a huge government bailout.

“Before the political momentum for reform dissipates into a single-minded dispute over how much to trust Americans’ retirement wealth to the stock market, or the president goes on the road again to stump for personal accounts, these larger questions need attention. Only then will the debate track Social Security’s original purpose—

meeting the basic economic needs of those considered old by the life expectancy and health standards of each generation.”

### **Supporters of PRAs Prepare Ad Campaigns**

According to a [report from CBSNews.com](http://www.cbsnews.com), groups with an interest in the personal retirement account issue have taken to the airwaves, coordinating nationwide campaigns aimed at steering the public debate. MoveOn.org’s first television ad on the issue immediately stirred up controversy, according to CBSNews.

“MoveOn.org released its own biting response to the president’s proposal. In a television advertisement, the group chides ‘George Bush’s planned Social Security benefit cuts of up to 46% to pay for private accounts.’

“MoveOn’s characterization of the Bush proposal as a *cut* in the system set off a wave of rebuttals and counter-rebuttals with Factcheck.org, a nonpartisan citizens’ advocacy group that seeks to point out deception and intentional confusion in politics. Factcheck accused MoveOn of falsely implying that the Bush plan would have a negative impact on current Social Security beneficiaries and disputed MoveOn’s assertion that it would result in direct benefits cuts for future generations. Noting that the president has not yet proposed a specific plan, Factcheck also argued that due to inflationary wage indexing, a reduction in currently projected benefits ‘would more properly be called a ‘freeze’ than a ‘cut.’”

“What MoveOn is doing is very similar to what we used to see when we talked about when budget changes brought before inflation were budget cuts or not, is it a cut before what you otherwise would have gotten?’ said Norman Orenstein of the American Enterprise Institute.

“Factcheck went on to classify MoveOn’s spot as a ‘false TV ad.’”

Supporters of private accounts are beginning to launch ad campaigns as well, according to CBSNews.

“The Club for Growth, a free-market advocacy organization, released an ad last week that urges viewers to call three undecided Republicans—Rep. Joe Schwarz of Michigan, Rep. Sherwood Boehlert of New York and Sen. Lincoln Chafee of Rhode Island—to support the president’s plan. The ad makes the case that while Social Security is safe for older Americans and baby boomers, younger workers who pay into the system will ‘get just a fraction back when they retire,’ if the system is not reformed. According to the group’s press release, the ad is intended to influence the above-mentioned undecided Republicans.

“This ad is a gentle message about the virtues of personal accounts and a blunt message that we are watching their actions on this issue with great interest,’ said the group’s president, former Congressman Pat Toomey.

“Progress for America is another conservative group that supports Social Security reform through private accounts. According to its Web site, it ‘promotes nonpartisan policies that stimulate the economy, reduce tax burdens on American families and businesses, and encourage free trade.’

“The group’s new 30-second spot frames the president’s proposal in a positive light, pointing out that no changes will be made for those 55 or over and calling Mr. Bush’s framework ‘the right thing to do for every generation.’ The ad features snippets from the president’s State of the Union address, when he made the case for changing Social Security in order to save it. ‘We have to move ahead with courage and honesty because our children’s retirement security is more important than partisan politics,’ says Mr. Bush.”

## **Events**

Cato’s Social Security University seminar will take place on the Hill, February 22–25. The four luncheon sessions will be held in the Rayburn House Office Building, room B-354 from 12:00–1:30 pm. Michael Tanner, director of Cato’s Project on Social Security Choice, will cover a new topic each day: Tuesday, the program and the problem; Wednesday, facts and fantasies about the system; Thursday, comparing proposals for reform; and Friday, the politics of reform. For more information and to register, click [here](#).

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