

# Social Security Choice

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

A WEEKLY NEWSLETTER ON SOCIAL SECURITY REFORM

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### ***SSA: Johnson Bill Achieves Permanent, Sustainable Solvency***

The Social Security Administration has “scored” Social Security reform legislation introduced by Rep. Sam Johnson (R-TX), concluding that the bill “would eliminate Social Security’s long-range actuarial deficit” and would restore the system to “sustainable solvency.” According to SSA’s actuaries, during the program’s 75-year actuarial window, “The overall effect of the proposal is to transform the projected \$3.7 trillion long-range unfunded obligation for the program under current law into an expected positive Trust fund balance of \$1.8 trillion at the end of the period.”

Johnson’s bill (H. R. 530), the Individual Social Security Investment Program Act, would give workers under age 55 the option of privately investing their half of the Social Security payroll tax (6.2% of wages) through individual accounts. Workers who do not choose this option would remain in the current system, but their benefits would be based on a price-indexed rather than the current wage-indexed formula. Workers choosing individual accounts would forgo future accumulation of Social Security retirement benefits, but would receive a tradable “recognition bond” based on those benefits already accrued under the traditional Social Security system. A new minimum benefit, equal to 100 percent of the poverty level, would ensure that no senior would end up in poverty. The legislation is based on Cato’s “6.2% Solution.”

The SSA memo also shows that:

- The “transition cost” (in present value) would be approximately \$6.5 trillion. This is slightly more than half the unfunded liability of the current system (using an infinite horizon measure). The legislation also compares very favorably to other Social Security reform plans. *In terms of giving workers more control and ownership of their retirement funds, Johnson’s bill clearly provides the most “bang for the buck.”*
- On a cash-flow basis, the legislation does require significant short-term transfers of general revenue. However, by 2046, the system would begin running a surpluses, allowing any short-term debt to be repaid. Indeed, by the end of the 75-year actuarial window, the system would be running surpluses in excess of \$1.8 trillion (in constant \$2005).

- Much of the short-term cash-flow shortfalls are due to the redemption of recognition bonds, not to the diversion of payroll taxes to the individual accounts. These recognition bonds convey many benefits in terms of ownership as well as speed the date at which Social Security changes from deficit to surplus. It is essentially a prepayment of future Social Security benefits, and is not a new expense. Johnson's bill is the only Social Security reform bill with recognition bonds. Adding recognition bonds to other bills would considerably increase their short-term cash flow deficits. The costs of the Johnson bill also include the cost of increasing the minimum Social Security benefit to 100% of poverty, a significant increase over the current minimum Social Security benefit.
- Individual accounts would eventually accumulate assets in excess of \$38 trillion (in constant \$2005). This would lead to substantial new savings, new investment, and economic growth.
- Once short-term debt is paid off, the employer portion of the payroll tax could be reduced to 3.04%. This would pay for disability and survivors' benefits.

The SSA analysis shows that Rep. Johnson's bill can provide large individual accounts while restoring Social Security to permanent sustainable solvency, and can do so in a fiscally responsible manner. While the up-front costs will be significant, they will be less than for other big account plans, and eventually those costs will be more than offset by the savings to the system.

### ***Leading Economists: There Is No Transition Cost***

In a special report from [Cybercast News Service](#), writer Jeff Johnson cites the "growing number of economists" who see that the so-called "transition cost" of moving to a prefunded Social Security system is simply a political fiction. The transition to a prefunded system will actually save money over the long run, not cost money. Included in the following excerpt are the comments of Nobel laureate Edward Prescott at Cato's recent Social Security conference.

"Transition costs, trumpeted by Democrats as a chief reason not to support President Bush's Social Security reforms, are a myth, according to several prominent economists, including the 2004 Nobel Prize winner.

"The trillion dollar totals that Democrats cite as 'transition costs' are actually the amount the government is borrowing to pay current Social Security benefits combined with the massive debt already owed to the so-called Social Security 'Trust Fund.'

"'We hear a lot about transition costs,' Arizona State University professor Edward Prescott, 2004 winner of the Bank of Sweden Nobel Prize in Economics, said. 'But I'm going to use some economic jargon, not 'political accounting' jargon.

"'There are no transition costs,' Prescott said at the Cato Institute on February 9. 'Re-labeling debt is not a cost.'

“Lawrence Hunter, senior research fellow with the Institute for Policy Innovation, told the Cybercast News Service that he agrees with Prescott.

“‘There are no transition costs,’ Hunter said. ‘There’s simply a cash flow crunch that exists and if Congress chooses to borrow the money to alleviate that, it has done nothing more than replace one form of debt ... with another. It’s refinanced the debt.’

“Congressional opponents of President Bush’s plan to move part of Social Security payroll tax revenues into personal retirement accounts tout the alleged ‘transition costs’ as a primary basis for their opposition.

“‘The president’s proposal would mean lower benefits, more risk to individuals and slower economic growth because interest rates will go up if he borrows \$1 trillion to \$2 trillion in order to fund the transition costs,’ liberal Rep. Tom Allen (D-Maine) told the *Portland Press Herald*.

“Left-wing media pundits are trumpeting the ‘transition cost’ concept as well.

“‘The plan will cost about \$2 trillion in ‘transition costs’ just to shift from the current system,’ claimed syndicated columnist Molly Ivins. ‘That’s \$2 trillion we don’t have, can’t afford and will have to borrow, with horrid economic consequences.’

“Even some Republicans in Congress are reserving judgment on the president’s proposal because of the alleged costs.

“‘I certainly am keeping my powder dry because I need to hear the projections on the transition costs,’ Rep. Jim Ramstad (R-Minn.) told the Minneapolis *Star Tribune* in January. ‘They’re all over the board.’

“Prescott and Hunter are two of a growing number of economists who argue that the so-called ‘transition costs’ are actually an accounting fiction, a misrepresentation of the current status of Social Security by those who do not want to see the system changed.”

For more on the myth of transition costs, see Cato’s research and commentaries on the issue [here](#).

### ***Tim Penny: Status Quo Is an Expensive Proposition***

In a recent commentary, former Democratic Congressman Tim Penny—now a widely recognized leader on Social Security reform—writes that defenders of only modest changes aimed at defending the traditional structure of Social Security rather than putting it on the road to permanent solvency are “defending an expensive status quo” at great cost to the financial security of American workers. In the following excerpt, Penny describes the proposals of the naysayers and their horrible consequences.

“Some suggest increasing the amount of income subject to the payroll tax. Currently, the 12.4 percent payroll tax is applied only to the first \$89,000 of annual income. Applying this tax to all income would certainly raise a lot of revenue—but it would essentially make the payroll tax an income tax. In effect, increasing the income

subject to the payroll tax would require Congress to basically repeal the recently enacted tax cuts—something Congress is unlikely to do.

“Other defenders of the status quo assert that a modest payroll tax hike could solve the problem. They propose a nearly two percent increase to take effect immediately. The major problem with this approach is that it assumes we can honestly save these dollars for future use. But we have NOT done that with the current Social Security surplus. Ever since payroll taxes were increased (as part of the Social Security fix in 1983), those surplus revenues have been placed in a so-called Trust Fund. The government has consistently used those Trust Funds dollars (totaling \$1.7 billion to date) to cover overspending in the rest of the budget. Given that history, by what logic do we believe any new payroll tax increases will be honestly saved?

“Another option is to transfer general fund dollars into the Social Security system. The logic of this approach is that the Social Security Trust Fund has been used to cover general fund obligations (or, better said, general fund deficits)—so it is only fair that the general fund return the money to Social Security when needed. Here is the rub. Over time, it would necessitate cuts in the general fund equivalent to the size of Food Stamps, Head Start, WIC child nutrition, the Small Business Administration, the Department of Interior, the Fish and Wildlife Agency, college student loans, the Food and Drug Administration, and more. Obviously, Congress is NOT going to do that. So, where will the money come from?

“On the other hand, if we wait until the year 2018 to raise payroll taxes sufficient to pay for Social Security’s ongoing needs, then over a short period of time the payroll tax would need to rise from 12.4 percent to nearly 19 percent of income. Surely, no serious person would argue for such an approach, which essentially punishes tomorrow’s workers for the shortsightedness of today’s policymakers. Younger workers are already paying far more in payroll taxes than previous generations—and we are still headed for a fiscal crisis in the program. That is one of the reasons younger Americans have come to believe that Social Security will not be there for them when they retire.

“The bottom line is this: The Social Security status quo is an expensive proposition. All the more reason for legislators of both parties to heed President Bush’s call for action to strengthen Social Security—before we have no option left except to raise taxes.”

### ***Charles Krauthammer: Bush Needs a Better Sell***

In his [Washington Post column](#) last Friday, Charles Krauthammer noted that the president may have erred in identifying 2042 as the date of reckoning for Social Security’s finances during his State of the Union address. Rather, as Krauthammer correctly notes, the important date for discussion is 2018, when Social Security begins paying out more in benefits than it receives in taxes. His comments, which follow, demonstrate why 2042 is such an inaccurate and dangerous date for the president to latch onto.

“I do not know if the president’s Social Security reform will pass, but if it does not, its demise will be traced to that point in the president’s State of the Union address

when he warned that the system would go bankrupt in 2042. It was a disastrous moment.

“First, it is hard to rally people to a crisis that you have located 37 years out. People 45 and older figure they will be dead anyway. And younger people have such a short time horizon that 37 years in the future is utterly meaningless. It does not matter if you have young children. A parent with young children can barely imagine them as teenagers, let alone as pre-menopausal 40-somethings.

“Moreover, the new millennium was always a science-fiction idea, and now that we are there, years beginning with a ‘2’ still seem fictional. Even 2011, the first boomer retirement year, has a Stanley Kubrick feel; 2042 lies somewhere in the Matrix.

“It gets worse. If 2042 were an actuarially significant date, all of this could be forgiven. The president would simply have to work extra hard on getting us to imagine it. But pointing to a date that will instantly lose 90 percent of the audience is doubly crazy when that date is meaningless. 2042 is the fictional date for the fictional bankruptcy of a fictional trust fund.

“Let’s start with basics. The Social Security system has no trust fund. No lock box. When you pay your payroll tax every year, the money is not converted into gold bars and shipped to some desert island, ready for retrieval when you turn 65.

“The system is pay-as-you-go. The money goes to support that year’s Social Security recipients. What’s left over is ‘loaned’ to the federal Treasury. And gets entirely spent. It vanishes. In return, a piece of paper gets deposited in a vault in West Virginia saying that the left hand of the government owes money to the right hand of the government.

“These pieces of paper might be useful for rolling cigars. They will not fund your retirement. Your Leisure World greens fees will be coming from the payroll taxes of young people during the years you grow old.

“*That is why 2042* is a fiction. The really important date is 2018. That is when this pay-as-you-go system starts paying out more (in Social Security benefits) than goes in (in payroll taxes). Right now, workers pay more in than old folks take out.

“But because the population is aging, in 13 years the system begins to go into the red.

“To cover retiree benefits, the government will have to exhaust all of its FICA tax revenue and come up with the rest—by borrowing on the world market, raising taxes or cutting other government programs.

“We have to reform the system. There is no free lunch. Private accounts are a fine idea for other problems, such as dependency and transferability to heirs. They are irrelevant to the solvency problem. We would have to raise taxes or cut benefits—or borrow, endlessly and ruinously.

“The Democrats’ plan is to stick their heads in the sand. The problem is that every year that we allow to go by means that the reduction in benefits or the increase in taxes will have to be larger. If we had started this in the fat years of the 1990s, we could have done it at reasonably low cost in benefit cuts and/or tax increases. We now have 13 years rather than 20 or so before the system starts bleeding red.

*“That is why* the president’s 2042 date is so disastrous. It makes it seem like the problem is very far away. True, he mentioned 2018, but bringing up 2042 simply muddies the logic. It reinforces the idea that there really is a trust fund from which we will be drawing to pay the elderly for the quarter-century between the years 2018 and 2042. There is not. It is just paper.

Moreover, 2042 creates the ridiculous distraction of the conflicting Congressional Budget Office estimate that the (fictional) trust fund becomes (fictionally) bankrupt in 2052—10 years later and 10 more reasons for Democrats to ignore the whole problem.

“To bring the silliness full circle, the president himself has since admitted that there really is no trust fund. But his 2042 date is based on the idea that there is. We will never be able to reform the system if the chief reformer does not clearly articulate what the impending crisis is, when it is coming, and why.”

### ***Rep. Martin Sabo’s Magic Social Security Plan***

Rep. Martin Sabo (D-MN) recently announced that he will be introducing a bill in Congress that he claims will guarantee Social Security solvency through 2080 by simply increasing the interest rate on Treasury bonds in the Social Security trust fund.

“With targeted yet simple adjustments to interest paid to the Social Security trust fund, we can fix the longer-term solvency problem without raising payroll taxes or cutting the benefits that Americans have earned through their own contributions to the system,” Congressman Sabo said.

Unfortunately Rep. Sabo fails to recognize that interest on Treasury bonds is funded by the Treasury and not produced from thin air. Getting interest rates high enough to keep Social Security solvent would require an enormous influx of income to the government, which would no doubt be provided by steep hikes in income and other taxes. Mike Tanner, director of Cato’s Project on Social Security Choice, said, “Why not take it a step further and mandate 200% interest? We could fund the entire government that way.”

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