



Social Security Choice

SOCIAL SECURITY THIS WEEK

A WEEKLY NEWSLETTER ON SOCIAL SECURITY REFORM

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Greenspan Urges Action on Social Security Reform

Testifying Wednesday before the House Budget Committee, Federal Reserve Chairman Alan Greenspan [told Congress](#) that delaying reform of Social Security and Medicare would only make the country's budgetary problems worse. Greenspan endorsed President Bush's plan to set up personal accounts but stressed that other actions would be necessary to put Social Security and Medicare back on sound financial ground. Every year of delay will make entitlement reform more difficult, he argued.

Greenspan pointed out that he believes the government has promised more than it can deliver to the 78 million baby boomers now nearing retirement. "If existing promises need to be changed, those changes should be made sooner rather than later," he noted. "In the end, the consequences for the U.S. economy of doing nothing could be severe." For a complete transcript of Chairman Greenspan's testimony, click [here](#).

Bush Kicks Off '60 Stops in 60 Days' Tour

The Bush administration [announced Wednesday](#) (registration required) a 60-day, 60-stop campaign to shore up support for the President's plan to introduce personal accounts to Social Security. Bush will travel at least one day a week until May 1 to talk about Social Security. Treasury Secretary John Snow, who will himself campaign two days a week, indicated that Bush would be open to compromise on Social Security reform options. This tour represents a significant push by the administration to convince the public that the current Social Security system is unsustainable and that personal accounts should be part of any plan to fix the program.

Scott Burns: Social Security in Trouble by 2008?

When it comes to Social Security's looming financial problems, Alan Greenspan has three words for us, [says Scott Burns](#) (registration required): Follow the cash. In recent testimony, Greenspan noted that problems with Social Security may begin not in 2052, 2042, or even 2018, but as soon as 2008. Greenspan worries that market expectations of excessive government borrowing will impact interest rates and the economy, affecting the rate at which surplus cash from the payroll tax disappears. Burns' commentary follows:

"In two days of grilling about Social Security, Federal Reserve Chairman Alan Greenspan put an important new date on our calendars: 2008.

"That's when he believes problems may begin with Social Security.

"Not 2052, the date the Congressional Budget Office estimates the Social Security trust fund will be exhausted and benefits will have to be reduced.

"Not 2042, the date the Social Security trustees estimate for the same event.

"Not 2018, the date the Social Security trustees estimate benefits will exceed revenues and it will be necessary to start redeeming the Treasury obligations in the famed Social Security trust fund.

"All those dates are pretty far off. Some of the legislators questioning Mr. Greenspan felt that the dates were so distant that Social Security must be a manufactured problem.

"But 2008 is just three years away. How could Mr. Greenspan believe the problem is so close when two major institutions are putting problems decades in the future?

"The answer is one word: cash.

"Mr. Greenspan is following the cash, not government accounting. He worries that market expectations of excessive new government borrowing will have an impact on interest rates and the economy. He wants to increase the pool of domestic savings so we can sustain investment and reduce our dependence on foreign lenders. Unless we do, he expects higher interest rates.

"That's why following the cash is important.

"Last year, payroll tax revenue for Old Age Security and Disability Income and Hospital Insurance was \$735 billion. Expenses were expected to be \$673 billion, leaving extra cash of \$62 billion to contribute to other government spending. (These figures exclude interest on the Social Security trust fund.)

“In their ‘intermediate cost’ projections, the trustees estimate a cash surplus until 2020.

“Historically, actual costs have run closer to the trustees’ ‘high cost’ estimate. (This is not an evil plot or something to bemoan – we keep living longer than expected, so Social Security costs more.)

“The high cost estimate has a smaller cash surplus. It also disappears much faster. The high cost estimate has Social Security and Medicare down to a mere \$28 billion surplus in 2008 and \$14 billion in 2009.

“Pocket change.

“It becomes \$7 billion of red ink in 2010. If you are reading about this in a daily newspaper in 2005, you can be sure global bond markets will start to take notice before 2010. Try 2008.

“OK, you might ask, but what about the interest on the trust fund? How can it be ignored?

“Easy.

“It isn’t cash. The U.S. Treasury doesn’t send a check for interest on the \$1.6 trillion in the Social Security trust fund. The interest is simply accrued, and a new Treasury security representing the interest is added to the fund. The interest accrued has no impact on the ongoing budget or ongoing spending because it never comes out of government cash revenue.

“Meanwhile, the continuing cash surplus from excess payroll tax revenue never goes into the trust fund either. It is simply exchanged for another Treasury obligation (read: IOU) that is added to the trust fund.

“What happens to that money?

“It has been a slush fund for politicians of both parties since 1983. It allows them to spend more because they don't have to borrow it from the public. Had this been done by a corporation, it would be the largest fraud in history, now at \$1.6 trillion and counting.

“The accrual of interest also explains one of the great mysteries of government fiscal reporting—how politicians of both ilks could crow over a ‘surplus’ when government debt continued to grow every year.

“President Clinton, a Democrat, bragged that his administration had produced a ‘surplus’ in 1998, 1999 and 2000. It also left a ‘surplus’ for President Bush in 2001. During that same period, government debt rose by \$291.7 billion. Then Mr. Bush, a Republican, used the same fictional surplus to justify tax cuts.

“In fact, this is a shell game that both parties play.

“In the four years of purported surplus, 1998-2001, the total ‘on-budget’ surplus (regular budget programs) was a dinky \$25.7 billion. Guess where the remainder of the surplus came from?”

“It came from the ‘off-budget,’ which is mostly Social Security. The surplus there was a whopping \$533.4 billion. Most of that cash reduced publicly held Treasury debt, the stuff that trades around the world, by \$401.5 billion.

“Unfortunately, gross debt—which includes obligations in the Social Security trust fund and other government trust funds, as well as publicly held debt—increased by \$291.7 billion during the same period of reported ‘surplus.’

“Mr. Greenspan has his eye on real cash flow, not the fictions of government accounting.

“He knows that surplus cash from the payroll tax is about to disappear.

“When that happens, government borrowing on the open market will increase. And global attention will be on the cash shortfall for Social Security and Medicare.

“That's why he's looking for trouble in 2008.”

Donald Luskin: Don't Raise the Cap

President Bush recently noted that he was open to all ‘good ideas’ for fixing Social Security, but raising the cap on income subject to the Social Security tax isn’t one of them, [writes Donald Luskin](#) in *National Review Online*. Though Bush has vowed not to raise taxes, lifting the tax cap would be a sneaky way of doing just that—it would amount to a new 12.4% tax on every dollar earned over the current cap of \$90,000. Not only would this be a ‘cruel marginal tax increase’ for those in the upper income ranges, it would also discourage work incentives and job creation. Luskin’s article follows.

“Should advocates of Social Security reform accept a hike in the cap on wages subject to the payroll tax as a fair price to pay to get personal accounts enacted?”

“No way. I’ve heard all the rationales for this, and none stand up to scrutiny when you take a hard look at the numbers.

“Currently, only the first \$90,000 of annual wages are subject to the 12.4 percent payroll tax dedicated to Social Security (a worker pays 6.2 percent directly, and an employer pays another 6.2 percent on his behalf). The wage cap is \$90,000 today; on earnings above the cap, no payroll taxes are assessed. President Bush has said many times that he will not consider raising the payroll tax rate of 12.4 percent. But the White House and Republican leaders have let it be known several times recently that they might consider raising the cap above \$90,000.

“Raising the cap would have no immediate financial impact on anyone earning less than \$90,000—a considerable majority of the working population. But for anyone earning more than \$90,000, it would be a tax increase of 12.4 percent on every dollar earned above \$90,000 up to the new higher cap.

“Let’s say the cap were moved to \$150,000, and you earn \$120,000. Your annual tax bill just went up by \$3,720. And what would you get for your tax hike? Not enough.

“If the current Social Security benefit calculations were kept in place, you would get an increase in future monthly benefit payments that would partially offset the tax hike. Let’s say you are 20 years from retirement at age 67. At retirement, the present value of the 20 years of additional taxes you will have paid is about \$103,000 (in today’s dollars). But the present value of the additional benefits you can expect is only about \$33,000.

“That puts you behind by \$70,000. Is that too high a price to pay for the privilege of being able to invest some of your payroll taxes in a personal account? Yes—way too high.

“Under the current White House proposal, you would only be able to invest \$1,000 each year into your personal account. According to my calculations, your personal account would have to earn at an average compound rate of 13.5 percent per annum for 20 years—after inflation—in order for your investment earnings to make you just whole for the \$70,000 gap between higher taxes and higher benefits.

“To put that in context, since 1926, the S&P 500’s total average annual return—again, after inflation—has been only 7.2 percent per annum (according to Ibbotson Associates). The 13.5 percent per annum required just to break even on a wage-cap tax hike to \$150,000 has historically been achieved in only 41 percent of all 12-month periods.

“Some persistently ask, don’t personal accounts have to be financed somehow? Well, no—or at least they don’t need any additional financing that the Social Security system doesn’t already need. Under the White House proposal, a worker who elects for a personal account agrees to give up a proportionate fraction of his future benefits in exchange for that account. The cost of diverting payroll-tax dollars into personal accounts today is perfectly offset by reduced benefit payments that will have to be made in the future. Yes, that will entail some public borrowing in the near term, but it will all be paid back to the penny out of lower benefit payments down the road.

“What about the idea that raising the cap on taxable wages will only fall on that minority of well-off workers who make more than \$90,000 a year? Wouldn’t taxing that minority have the virtue of making personal accounts possible for the vast majority of less-well-off workers who, arguably, need them the most?

“First, there probably aren’t that many people making \$90,000 a year who would consider themselves rich. And as with all class warfare strategies, the ones who expect a free lunch out of the deal have to contend with the reality that you can’t eat the rich and have them too. Lifting the wage cap would impose a cruel marginal tax increase on anyone earning between \$90,000 and the level of the new cap. Stunting job creation and labor-force participation among that population of workers would slow overall economic growth — and slower growth always ends up hitting the little guys hardest of all.

“There’s no getting around the fact that raising the wage cap is a tax increase. For millions of workers—most of whom are hardly ‘rich’—such a plan would more than reverse the effects of the president’s 2003 tax cuts. Those millions of workers would not see their increased tax payments offset either by the gains of having Social Security personal accounts or by increases in Social Security benefits.

“And the wage-cap tax increase is completely unnecessary as a means of financing the establishment of personal accounts—for that, no financing is needed in the first place.

“President Bush recently said he was open to all ‘good ideas’ that can help reform Social Security. Lifting the wage cap is a bad idea: bad for Social Security reform and bad for the economy.”

Heartland Institute: Figuring Out Social Security Reform

Financial insolvency isn’t the only compelling reason for Social Security reform, argues Joseph Bast in [an article](#) published by the Heartland Institute. Besides being headed for financial straits, Social Security is fundamentally unfair to women, African-Americans, and those who die before retirement. Furthermore, Social Security discourages job growth, personal savings, and investment, and has impeded the development of a market for long-term care insurance, which could be a private alternative to welfare for the elderly.

Social Security requires changes, but small reforms—like raising the retirement age or raising the cap on taxable income—aren’t enough, and don’t address the “underlying unfairness, inefficiency, and unintended consequences of the program.” President Bush’s plan to allow private accounts would help reduce the unfairness of Social Security and give Americans more say in their retirement planning. Bast’s piece follows.

“President George W. Bush continues to confound those who think conservatives oppose change while liberals (or ‘progressives,’ as they now prefer to be called) support it.

“In his February 2 State of the Union address, Bush called for reform of environmental regulations to make them more cost effective, tort reform to limit lawsuit abuse, tax simplification, and reducing or eliminating 150 federal government programs.

“Most controversial is Bush’s call to ‘strengthen and save’ Social Security, the nearly 70-year-old entitlement program that will be unable to continue to pay benefits in as little as 12 years according to some measures or around 2040 according to others. ‘Progressives,’ so eager to boldly go where no society has gone before in other areas of social and economic policy, are afraid to touch Social Security.

“Social Security was sold to voters and workers by Franklin D. Roosevelt as a forced savings program, with every worker given his or her own account. It was good politics, but a big lie. The individual accounts are an accounting fiction. Past retirees got vastly

more than they paid in, recent retirees are likely to get about what they put in (but with little or no interest), and future retirees are likely to get much less, even assuming the program stays 'solvent.'

"I put the word solvent in quotation marks because by generally accepted accounting principles, Social Security is already bankrupt. By 2018, spending will exceed revenues and by 2042, the so-called Trust Fund will be empty. The Trust Fund, however, is already empty. Social Security has long operated as a pay-as-you-go scheme, with taxes paid by workers today going to pay for benefits of those already retired. The 'surplus' was invested in government bonds and immediately spent by the federal government.

"Since the federal government is in debt to the tune of \$7.4 trillion (an amount that is rising by half-a-trillion dollars a year), those bonds cannot be redeemed without spending cuts or tax hikes equal to the amount due.

"The impending bankruptcy of the Social Security system is a compelling reason for reform, but not the only reason. Social Security is profoundly unfair to women who work, who receive fewer benefits than men, and to blacks, who have shorter lifespans and therefore are less likely to collect benefits or collect them for as long as whites. It is unfair to anyone who dies before retirement because all the money paid in Social Security taxes, except for a token death benefit, is kept by the government. Your heirs get nothing.

"Social Security is a job killer because it increases the cost of hiring someone by 12.4 percent—the total of the employer and employee's share of Social Security taxes. It discourages personal savings and investment in stocks and bonds by offering the false promise of a government-financed comfortable retirement. It has severely handicapped the creation of a market for long-term care insurance, which could be a private alternative to welfare for the elderly.

"In all these ways, Social Security falls far short of what we would want and expect from a modern retirement program.

"Democrats and some Republicans say we can save Social Security simply by raising the payroll tax or lifting the cap of \$90,000 on the amount of income on which the tax is owed. There are several problems with this. The payroll tax is already too high: Most Americans pay more in Social Security taxes than they pay in personal income taxes, and it's a major obstacle to savings and investment for millions of low- and middle-income Americans.

"The Social Security tax rate in 1965 was about 2 percent. Now it's 12.4 percent. In 40 years it would have to be 18 percent or higher to keep up with the demands of retiring baby boomers. That would be on top of federal and state income taxes, sales taxes, property taxes, and all the other taxes people pay. The combined weight of such a tax burden would be profoundly unjust and crush the economy.

“Raising the cap on taxable income means concentrating the cost on the most productive people in the country, the same people who already pay 80 percent or more of personal income taxes and who are our only hope of winning the economic competition with China, India, and other rapidly growing nations. If you oppose ‘outsourcing,’ you should oppose raising the Social Security income cap.

“The collapse of Social Security can be put off by gradually raising the age at which people qualify for benefits and slowing the rate of benefit growth by tying it to the rate of inflation rather than income growth. But these reforms do not address the underlying unfairness, inefficiency, and unintended consequences of the program.

“As Bob Costello wrote a year ago, ‘We need to turn the current Social Security crisis into an opportunity to modernize the system to give individual workers control and ownership over their retirement assets. [Personal Retirement Accounts] would give every worker dignity and a sound, stable financial plan that no one—not even the politicians—could take away.’

“During his State of the Union address, Bush ruled out raising Social Security taxes but said everything else is on the table. He particularly wants to allow individuals to put part of their Social Security taxes into privately managed savings accounts. He assured people who are 55 or older, ‘For you, the Social Security system will not change in any way.’

“Bush’s plan, which is only the starting point for negotiation, would allow individuals born after 1950 to divert about two-thirds of their payroll taxes (about 4 percent of gross income), up to a cap of \$1,000 a year, into private retirement accounts. The cap would increase by \$100 a year after the first year. People choosing to open these accounts would see their benefits under Social Security reduced proportionately.

“The creation of private savings accounts is a good idea, though Bush’s plan is too modest. Accounts much larger than those Bush proposes would empower people by giving them more say in their savings and retirement planning. Such empowerment would make them act more responsibly, which benefits everyone.

“Private accounts reduce the unfairness of Social Security to women and minorities by giving them access to the funds they set aside for retirement and making it inheritable. Private accounts would stimulate economic growth because account managers would invest in stocks and bonds, which support businesses that are creating new products and expanding markets. Faster economic growth, in turn, fuels the tax revenues needed to keep the rest of the Social Security program viable.

“The long-term viability of Social Security is also enhanced because every dollar diverted from the program means at least a dollar less in future liability. This is why talk of a ‘transition cost’ for the Bush plan is very misleading. In the short term, the diversion of funds may create the appearance of a larger deficit, but the long-term liability is decreased by an equal or larger amount, so there is no actual cost.

“Despite the strong case for privatizing Social Security and high expectations created by Bush and some beltway think tanks, the path to reform will be long and difficult. It will probably take years for the House and Senate to agree on a reform plan, with nearly all Democrats opposing the process every step of the way. Special-interest groups such as organized labor and AARP will use the issue to raise hundreds of millions of dollars from their members to wage misleading campaigns to ‘save Social Security.’

“Social Security reform is a good idea, and one that will be debated for many years. But don’t expect quick political action.”

Lott and Hansen: Increased Debt is an ‘Accounting Fiction’

Critics of personal accounts often point to increased debt as one reason for maintaining the current system. In a recent article, economists John R. Lott Jr. and Robert G. Hansen [explain why this line of thinking is wrong](#). This is because today’s transition costs will merely replace tomorrow’s Social Security debt, there would be no net debt increase. In essence, the critics are forgetting that these debts already exist and need to be accounted for. Lott and Hansen go on to illustrate exactly how the government might go about funding the transition to personal accounts without raising additional debt. Excerpts from the article follow.

“As another way to see how real the government’s future obligations on Social Security are, there is a very simple way for the government to create personal retirement accounts without raising any additional debt.

“All the government has to do is allow individuals to sell some portion of their future Social Security benefits in exchange for a lump sum payment today.

“Wall Street makes these present value and life expectancy calculations all the time for annuities. Individuals who receive the lump sum payments would turn around and invest the money in diversified funds approved by the government and that would hold some mixture of stocks and bonds.

“The entire round trip is a net wash: banks raise money by selling debt that is backed by current Social Security promises, but individuals immediately return the same amount back to the capital markets.

“The net drain on capital markets is zero.”

Publications

The Heritage Foundation has a new Backgrounder entitled “How Today’s Social Security Works.” Author David C. John details the different components of Social Security, including the payroll tax, benefit formulas, the trust funds, wage indexing vs. price

indexing, and a host of other rules and regulations that are seldom covered in the media. Read the executive summary [here](#) or download the full report in PDF format [here](#).

The National Center for Policy Analysis released a trio of brief analyses related to Social Security reform last week. “Social Security Reform: Reducing the Risk of Poverty,” by Dr. Estelle James, can be found [here](#). “Social Security Reform: Keeping Administrative Costs Low,” also by Dr. James, is [here](#). And “Social Security Reform: Looking At the Options,” by NCPA senior policy analyst Matt Moore, is [here](#).

Events

Upcoming debate: “Social Security: Is It Really a Crisis?”

If you live in the New York City area, join us for a free public debate featuring Cato’s Michael Tanner, *New York Times* columnist and economist Paul Krugman, and blogger/investigative reporter Joshua Micah Marshall.

Date: Tuesday, March 15, 2005, 7:00 p.m – 8:30 p.m.

Location: New York Society for Ethical Culture, 2 West 64th Street at Central Park West (Subways: 1/9 to 66th St.-Lincoln Ctr. or A/C to Columbus Circle)

Seating is limited and there are no reservations so be advised to arrive early.

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