



Social Security Choice

SOCIAL SECURITY THIS WEEK

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Grassley to Bush: Make Social Security Campaign Issue

President Bush should make a plan to partly privatize Social Security a central issue of his re-election campaign, according to Senator Charles Grassley (R-IA). Grassley, who as chairman of the Senate Finance Committee is key to any Social Security reform effort, told the National Association of Manufacturers this week, "My plan is to encourage the president to make personal accounts an issue in the campaign." Grassley said that by campaigning on the issue, Bush would pave the way for him to take up legislation next year setting up a system of private Social Security accounts.

Although Senator Grassley has supported individual account legislation in the past, in recent years he has been reluctant to bring up the issue. His remarks were welcomed, therefore, by personal account advocates who said that they showed how much the political terrain had shifted. Polls continue to show a majority of voters supporting proposals to allow younger workers to privately invest a portion of their Social Security taxes through individual accounts. In recent campaign speeches, President Bush has restated his support for individual accounts, and there are indications that the president will campaign on the issue this fall.

Investor's Business Daily Backs Cato's 6.2% Solution

An editorial in the February 25 *Investor's Business Daily* highlights the wisdom of [The Cato Institute's 6.2% solution](#) for private retirement accounts. The editorial sets up the problem facing Social Security by asking, "How is Social Security going to meet its commitments if it's taking in less money than it owes in benefits?" The answer, it suggests, is to look at reform ideas that provide choice to American workers, such as the 6.2% solution. Excerpts of the editorial follow.

"To keep Social Security afloat when its outlays begin to exceed its income, Washington could raise the payroll tax, now at 12.4%, to nearly 19%; it could hike income taxes by roughly half to bridge the gap; it could cut benefits, by at least as much as 27%, according to some; and it could even raise the retirement age.

“Or Washington could choose real reform and establish a system of private accounts, a long-ignored idea that is gaining traction.

“Private accounts have a drawback, though: How will current and future benefits be paid if revenues are diverted from the trust fund into personal investments? Enter the Cato Institute’s 6.2% solution.

“Under this proposal, workers born on or after Jan. 1, 1950, can choose to place their portion of the payroll tax—6.2% of the first \$87,900 earned in a year—in a private account. They would waive any future accrual of Social Security benefits and get a bond upon retirement based on the amount they had put into the system.

“The employer portion—the other 6.2%—would be used to pay the transition costs needed to keep benefits flowing to current retirees and future retirees who don’t opt for private accounts. Other sources—money saved by killing corporate welfare and higher tax revenues created by the increased economic activity that private accounts will generate—would also be used to fund the transition.

“Though there is a lot to like about this option, we’re not saying it is precisely the reform Congress must adopt. What lawmakers have to do, however, is correct Social Security’s path to ruin and provide Americans with more choice—and soon, because it’s getting late.”

Gokhale and Smetters Make the Political Case for Reform

In a recent *Washington Times* editorial, Cato senior fellow Jagadeesh Gokhale and Wharton School professor Kent Smetters suggest that Social Security reform could be a political winner for the president if he were to direct the focus of the Social Security debate on future net costs, rather than on “flawed budget measures, including deficits and debt.”

“Social Security’s future financial shortfalls are so large,” Gokhale and Smetters point out, “that even when they are discounted in value to recognize interest costs they add up to a large total. According to the 2003 Social Security trustees’ report, Social Security currently faces a financial shortfall of \$10.5 trillion in present value, equal to about 100 percent of GDP. Each year that passes without a reform makes that shortfall larger, and it increases the cost of fixing the program’s finances, hence the need for immediate corrective measures.”

As opponents criticize reform measures that appear to create deficits, the president’s economic report points out that when future costs are taken into account, there is no additional burden placed on the economy: the initial “deficit” that critics decry is a deficit created by the current Social Security system, not by attempts to reform it.

“Instead,” write Gokhale and Smetters, “the report argues that the appearance of deficits could potentially undermine the political case for reform.” They continue, “The \$10.5 trillion present value calculation made by the trustees includes all future costs net of dedicated revenues. If the focus were instead redirected toward this number, then the political case and economic case for reform would be the same and very strong.”

Bloomberg News: Social Security a “Demographic Time Bomb”

In an exhaustive look at the issues raised by Federal Reserve chairman Alan Greenspan's remarks last week, Caroline Baum announces in *Bloomberg News*, “Social Security, the untouchable third rail, is in play.” The crisis in Social Security, writes Bloom, is that Social Security is “a pay-as-you-go system (the nice way to describe it) or a government-run Ponzi scheme. In a nutshell, one person's payroll taxes are used to pay another person's retirement benefits.”

“In 1950,” she continues, “there were 16.5 workers paying taxes for every retired person receiving benefits. Now there are 3.3 workers per retiree. By 2020, the ratio will be 2.6 to 1, according to the Social Security Administration. In 2080, there will be 1.8 workers for every retiree.” Baum goes on to describe exactly how, why, and when the trust fund's assets will be exhausted. And the solution? Private retirement accounts. The following passage includes Baum's description of some of the political issues involved in reform and the promise of a private account solution.

“‘The Social Security Administration is legally authorized to issue benefit checks only as long as there are sufficient funds available in the Social Security Trust Fund to pay those benefits,’ writes Michael Tanner, director of the Cato Institute's Project on Social Security Choice, in a paper entitled [‘The 6.2 Percent Solution.’](#)”

“Greenspan's proposals, which landed like a lead balloon, called for raising the retirement age and lowering the annual cost-of-living adjustments by using a better (lower) measure of prices. (In a period of 24 hours, Greenspan managed to alienate two powerful lobbies: Fannie Mae and the AARP.)

“The Budget Committee was probably sorry it asked for Greenspan's advice. Representatives are on a two-year election cycle, and there isn't much time between settling into one's office and hitting the campaign trail to deal with issues, the solutions to which are sure to alienate voters.

“‘I'll make a prediction today: Not one member of this Budget Committee—and there are a lot of good responsible members on both sides of the aisle—will officially embrace major cuts in present services for Medicare or Social Security, some of the issues that you raised in your testimony,’ Texas Democratic Congressman Chet Edwards told Greenspan in a Q&A following his testimony.

“Just in case any of our elected representatives were inclined to take prophylactic action, Senate Democrats sent a letter to President Bush Friday asking him to reject Greenspan's suggestion ‘to balance the budget by breaking our promise to America's seniors.’

“A more viable option is transitioning to private retirement accounts. Tanner's plan for reforming Social Security—not just preserving the current system but providing better retirement benefits and a higher return for workers—would establish voluntary personal accounts for workers born after 1950. Those choosing this option would divert the employee portion of the payroll tax (6.2 percent of earnings up to a designated amount) to individually owned, privately invested accounts, to be invested in a balanced fund of stocks and bonds.

“The other 6.2 percent would be used to fund the transition costs—paying the benefits of those who remain in the current system. Eliminating what Cato has identified as \$87 billion annually in corporate welfare would provide additional income. And, to the extent that increased savings means increased investment, a portion of the funds diverted to individual accounts would be ‘recaptured in the form of the corporate income tax,’ Tanner says.

“That still leaves about half the transition cost to be financed by debt, the present value of which is still less than the present value of Social Security’s \$11.4 trillion unfunded liability. (Tanner has submitted his plan to the SSA for scoring.)

“The late 1990s demonstrated how economic growth can reduce deficits. It can’t cure a demographic mismatch.

“‘There is no way to grow our way out of this,’ Tanner says. ‘Benefits are linked to growth as well as revenues. So if the system takes in more revenue in the short term, it owes more out in the long term. During the Clinton boom, the unfunded liability of Social Security increased.’

“To put the system on sound financial footing for the next 75 years would require annual growth in real wages that is consistently 2 percentage points above the historical average—something Social Security actuaries see as highly unlikely.

“Greenspan was surprised at the firestorm his comments created because he’s talked about the coming crisis in Social Security for 20 years, according to Friday’s *Wall Street Journal*.

“Unlikely. As a Washington veteran, Greenspan knows when he goes up to Capitol Hill to discuss politically contentious budget matters, it’s going to make waves—especially when he casts a vote on the tax-cut debate. (He came down on the side of spending cuts rather than tax increases to close the current deficit.)

“Congress may not like the solutions proposed by Greenspan. It may not relish the hard choices it will have to make to fix the retirement system. And it may well choose to ignore the problem until the system faces imminent insolvency.

“What Congress can’t do is stuff the cat back in the bag.”

Corzine, Dorgan, Schumer Launch Internet Petition to Preserve Social Security Status Quo

In the wake of Federal Reserve chairman Alan Greenspan’s warning that Social Security cannot pay the promised level of future benefits, Senators John Corzine (D-NJ), Byron Dorgan (D-ND), and Charles Schumer (D-NY) have launched an Internet petition campaign rejecting any changes to the troubled retirement program. The petition urges President Bush to repudiate Greenspan’s remarks and pledge to preserve Social Security as it is today.

“We are writing to respectfully urge you to publicly reject Federal Reserve chairman Alan Greenspan’s recent remarks recommending significant cuts

in Social Security benefits. As you know, Mr. Greenspan called for raising the retirement age above 67 and slowing the rate at which benefits are adjusted for inflation. We believe that implementing this proposal would be tantamount to turning our backs on our nation's seniors.

“For nearly seventy years, the federal government has had a pact with Americans that if they work hard, pay their taxes, and play by the rules, they will be able to retire and get their Social Security benefits in return. Social Security has grown to become an essential facet of American life, with one in every six Americans receiving a Social Security benefit and 98 percent of all workers covered by Social Security. Today, almost 45 million people receive these benefits.

“The Social Security Trust Fund is currently projected to remain solvent until 2042 and the average monthly Social Security benefit is only about \$900 per month. We disagree with those who believe that this is too much to promise seniors who have worked hard, paid into the system, and made an honest living. We believe it would be wrong to balance the budget by breaking our promise to America's seniors.

“We hope you will publicly reject the statements of Chairman Greenspan and assure all Americans that Social Security benefits for both current and future retirees will be preserved in full.”

Of course, the statements in the petition are misleading. Social Security's financing problems start in 2018, when the program begins running a deficit, not in 2042 when the IOUs in the Trust Fund are exhausted. But more importantly, the senators fail to say what they would do to fix Social Security. It was former president Bill Clinton who spelled out the very limited options for reform: a) raise taxes; b) cut benefits; or c) invest privately. All three senators are on the record in opposition to allowing younger workers to privately invest a portion of their Social Security taxes through individual accounts. As they are now also rejecting any change in benefits, are they proposing a tax increase?

For more information on the limited options for reform, see Michael Tanner's "[No Second Best: The Unappetizing Alternatives to Individual Accounts](#)," Cato Institute Social Security Paper no. 24, January 29, 2002.

Cato's Jagadeesh Gokhale Live Online at the Washington Post

Last Wednesday, Jagadeesh Gokhale, senior fellow in health and welfare studies at Cato, participated in an online discussion with *Washington Post* readers about Social Security. Gokhale answered questions on everything from Alan Greenspan's remarks on the future projected shortfalls of the system to Medicare to the basic workings of the current system. Excerpts of the discussion follow.

Dulles, Va.: I think it's fair to let all the 40 and unders opt out now, but then how will we fund it for the workers and retirees left in the system?

Jagadeesh Gokhale: The funding shortfall exists under current law no matter whether those under 40 are allowed to opt out. The proper comparison standard for “opt-out” proposals is not that the program’s scheduled benefits are payable. That’s obviously a false standard. Allowing some young generations to opt out does not imply that the system’s overall finances change. For example, those opting out may have to accept a dollar-for-dollar cut in their future benefits in present discounted value terms. That would leave the system in the same financial position as it is today. These so-called “transition cost” problems arise only under a short-term view of the program’s finances.

Eastford, Conn.: If Social Security retirement benefits are paid from a “Trust Fund” separate from the general budget, how can reducing retirement entitlements reduce the federal deficit?

If there is no true “Trust Fund,” then where are the OASDI reserves being held, which are currently building up after the 1983 adjustments?

Jagadeesh Gokhale: The way financing works is

1. Payroll taxes come in to the Trust Fund (TF)
2. Benefits are paid by the TF
3. The surplus revenue is handed to the general government account.
4. The general government hands the TF an IOU--special issue (non-marketable) security.

In the future, benefit outlays will begin to exceed revenues... (in 2018) Then, the TF will have to redeem its IOUs—take money back from the general government and return its IOUs. The government today, is spending the money, not necessarily investing it (it's hard to know which).

Therefore, future redemptions of the TF IOUs must imply higher taxes or lower non-Social Security spending. Reducing future entitlements will push ahead the date when the revenue shortfall begins to bite in this manner (that is, force higher taxes or outlay cuts).

Albany, NY: As you know there is a ceiling on the income that is taxable under the payroll tax. A recent Brookings Institution book stated that removing this ceiling would completely restore solvency to the Social Security system. Do you think that altering the wage ceiling would be politically feasible, and what do you see as the economic effects that such an action would have?

Jagadeesh Gokhale: A program for providing social insurance should not be funded out of 12.4 percent of Bill Gates’ income. Why don't we have 100% marginal tax rate on income above a certain level?

If we subjected all earnings to the payroll tax the benefit formula implies that high-earners benefits would also be increased--albeit at a lower marginal rate. However, the net contribution to solving the financial shortfall may not be much.

The entire transcript is available [here](#).

WSJ Looks at Bush, Kerry Positions on Social Security

There is a real opportunity this election year for a more substantive debate on Social Security than usual, says David Wessel of the *Wall Street Journal*. Given the looming insolvency of Social Security, both major party candidates will surely be called upon to present comprehensive plans for the future of America's flawed pension program as the campaign unfolds. Plans to fix the system, he notes, must involve either an increase in revenues or a decrease in expenditures, or possibly a combination of the two. Wessel outlines the positions of President Bush and Democratic frontrunner John Kerry in the following excerpt:

“President Bush describes personal accounts as if they're a painless way to fix Social Security. Despite their appeal, personal accounts alone won't cure Social Security's ills. Don't take my word for it. In a presentation drafted for President Bush in October 2001, his economic advisers said: 'Even with the higher [investment] returns from personal accounts, there are only two ways to make the program fiscally sustainable: (1) Increase revenues....(2) Decrease expenditures.'

“Ruling out higher payroll taxes, his advisers said the only options for (1) were general tax revenues or 'voluntary contributions' to individual accounts. For (2), they offered one choice: 'Slow the rate of benefit growth in the future'—pay baby boomers and their children less than the benefits promised by current law. (This was among documents former Treasury Secretary Paul O'Neill gave author Ron Suskind, a former Wall Street Journal reporter.)

“Neither Mr. Bush nor his challenger, Massachusetts Sen. John Kerry, offers a detailed fix for Social Security. On this issue, politicians often seek a compromise that no one person or party gets blamed for fathering.

“But Mr. Bush's Council of Economic Advisers has analyzed favorably a plan to: allow workers to divert some payroll taxes to personal accounts in exchange for reduced benefits later; have the Treasury borrow heavily to pay current benefits; and reduce future retirees' benefits across the board by altering the formula by which they're figured.

“Mr. Kerry is emphatic about what he won't do. He won't 'privatize' Social Security. (Someone must have focus-grouped that verb.) He won't put Social Security funds into stocks. Taking safe positions that campaign managers love, he vows to name a commission to study Social Security and 'to do more to help workers save for retirement outside of Social Security.'

“But Mr. Kerry has thought, or been briefed, about the tough stuff. In Brooklyn over the weekend, he seemed to make the case for a higher retirement age. When Social Security began, he said, 13 workers were paying into the system for every retiree. 'Your life expectancy was 62,' he said, in the staccato of the campaign trail. 'Sixty-five retire. Life expectancy 62. Thirteen people paying in. It works.' My colleague Jacob Schlesinger reports that after the laughs subsided, Mr. Kerry said, 'Today, you've got about three people paying in, and soon it may go down to two, and your life expectancy is well into the 80s.'

“He didn’t pursue this to its logical conclusion, the logic that leads nearly all experts to predict an increase in the age at which full benefits are available. That’s now 67 for those born after 1959. Workers can retire at 62, but get smaller monthly checks.

“On this, Mr. Kerry does the tiptoeing of a candidate who wants to avoid endorsing or ruling out an unpopular change that he knows is inevitable. On NBC’s ‘Meet the Press,’ he said flatly, ‘I’m not going to lift the retirement age or make it harder for hard-working Americans to retire.’ But to the AFL-CIO, he has said, ‘Even though life expectancy has increased, it doesn’t mean that all workers—particularly those who work on their feet—can work until 70 or beyond.’ Ask his campaign policy adviser, Sarah Bianchi, to clarify and she says: ‘He is pretty much against raising the retirement age. He is worried about those folks who do work on their feet in manufacturing or waitressing.’

“Over the weekend, Mr. Kerry tried out a new pitch, musing about ‘ways in which you can begin to think about making Social Security fair.’

“‘If you live well into your 80s, those people who are multimillionaires in America are collecting checks from people earning 25, 30, 40, 50 thousand dollars a year. Now tell me how that makes sense?’ he said in Brooklyn. Or, as he put it on ‘Meet the Press,’ ‘I don’t understand why John Kerry . . . ought to be getting [Social Security benefits] from someone earning \$22,000, if I were lucky enough to live into the 80s.’

“When candidates talk like that, there’s often an idea lurking. Ms. Bianchi says Mr. Kerry has in mind changing the formula used to compute retiree benefits to make them less generous to higher-wage workers. He isn’t specific. One plan circulating outside the campaign would fix about one-quarter of Social Security’s money woes by shaving benefits for workers who earn \$87,000 a year by about 11% while boosting benefits for lower-wage workers. This approach, some Republicans would surely note, would make private accounts look all the better to higher-wage workers.

“Perhaps this year’s Social Security debate won’t be devoid of substance after all.”

Publications

The American Academy of Actuaries released its “Election Guide 2004: The Questions Candidates Should Answer about Social Security Reform” this week. An Academy press release says the guide provides “a brief background on six of the major reforms discussed in recent years (changes to the benefit formula, changes in the taxation of benefits, financing, means testing, raising the retirement age, and individual account proposals), and provides a series of questions to be posed to candidates who make reform proposals.” Eric J. Klieber, chairperson of the Academy’s Social Insurance Committee, said that given the importance of knowing a candidate’s position on Social Security before going to the polls, the paper is meant to be “a tool that journalists, policy-makers and citizens can use to evaluate candidates’ positions on Social Security reform.” The full text of the guide can be found on [the Academy’s website](#).

Upcoming Events

Citizens for a Sound Economy's "Own Your Future: Social Security Reform Tour" hits Florida on March 23, 24, and 25 with stops in or near Palm Beach, St. Lucie, and Ft. Lauderdale. Join CSE to discuss the Social Security crisis, how Personal Retirement Accounts can bring real retirement security, and the prospects for passing reform in the next 18 months. For more information, visit [the CSE website](#) or call John Hallman at (561) 392-4432.

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