CATO PROJECT ON
Social Security Choice

SOCIAL SECURITY THIS WEEK

A WEEKLY NEWSLETTER ON SOCIAL SECURITY REFORM

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Cato Plan Touted as Viable Option

An editorial in the *Wheeling WV Intelligencer* calls Cato's "6.2 Percent Solution" a "plan worth considering," noting the feasibility and realistic nature of the plan. The editorial also emphasizes the importance of Cato's plan in lieu of Social Security's financial crisis and the dearth of specific proposals from Congress. These factors combine to make Cato's reform plan an important addition to the debate and a possible solution for the system's financial woes, according to the main points of the editorial, which follow:

"Some of the best work on Social Security in recent years has come from the Cato Institute, a think tank with a libertarian bent. Cato has assembled a platoon of finance experts from Wall Street to design a workable reform plan that maximizes individual choice, protects retirees and those close to retirement and minimizes 'transition costs' to a new system.

"Cato's proposal is elegantly simple:

- Allow individuals born after Jan. 1, 1950, to divert their half (6.2 percent) of the Social Security payroll tax to individually owned, privately invested accounts. Those who choose this option would agree to forgo future accrual of traditional Social Security benefits.
- The remaining portion of payroll taxes would be used to fund disability and survivors benefits, as well as the transition costs. (Because Social Security is in essence a legal pyramid scheme, continuing support of benefits for retirees, near-retirees and those who choose to stick with the present system would be required.)
- Workers who choose the individual account option would receive a 'recognition bond' based on the earned value of their lifetime-to-date benefits; the bonds would be tradable securities, redeemable upon retirement.
- Those who wish to remain in the current system could do so.

"Assuming that a significant number of younger workers choose individual accounts, the proposal would be a huge boost to national savings. And to some degree, for reasons too complex to discuss in this space, this increased savings would help to offset some transition costs.

“There is, of course, no free lunch. Congress would have to, of all things, behave responsibly and trim some other spending in order to fully fund those transition costs. But it is important to note that the upfront costs of a transition to substantial individual accounts as Cato proposes are far, far less than the cost of propping up the current system.

“Is Cato’s proposal the right solution? Maybe and maybe not. But give Cato credit for putting a specific, substantial proposal forward, which is more than either the White House or Congress has done.”

Penny: Nonpartisan Voices Prove Need for Reform

According to a recent article by Tim Penny, former member of the President’s Commission to Strengthen Social Security, nonpartisan acceptance of Social Security’s dire financial situation will allow the program to become “a major campaign issue” this fall. Penny states that the Congressional Budget Office, the General Accounting Office, and, most recently, Federal Reserve chairman Alan Greenspan have acknowledged that retiring baby boomers will “quickly overwhelm the ability of the system to pay promised benefits.” This situation should prevent candidates from ducking the issue as the program’s problems continue to attract more attention.

Penny begins: “For nearly 70 years, the ‘pay as you go’ nature of the Social Security system has worked reasonably well.” However, Penny points out, “the payroll tax has been increased to ensure enough annual revenue to pay promised benefits. When first enacted, the Social Security payroll tax of 2 percent applied to the first $3,000 of a worker’s income. Today the tax is 12.4 percent on the first $87,900 of income.”

Along with increasing the overall tax burden, such payroll tax increases have helped make Social Security a bad deal for workers by decreasing the rate of return on their contributions to the system. According to the Social Security Administration, the average worker can now expect a rate of return of less than 2% on his or her payroll taxes—much less than the returns projected by a system of private accounts.

Penny continues: “But the baby-boom generation is twice as large as the current crop of retirees—and soon there will not be enough paying workers to finance the program.

“The numbers are relentless. The most recent Social Security trustees’ report calculates that by 2018, payroll taxes will be insufficient to cover annual Social Security benefits.

“At present, there are approximately 3-1/2 workers for every retiree. But by 2030, when baby boomers are fully retired, there will be only two workers per retiree. Clearly, something has to give—and Greenspan’s testimony alerts us to the fact that doing nothing is not an option.

“In response to Greenspan’s alarm bell, many politicians will insist that the Social Security trust fund will buy us some time. But, in reality, the trust fund is not a government asset, it's a liability. Why? Because the payroll-tax surplus has been used routinely to mask overspending in the rest of the federal budget. Special Treasury bills have been issued to the trust fund. However, they amount to no more than an IOU. The only way to honor these trust-fund obligations is to raise taxes, cut other government programs, or borrow money. Obviously, none of these is a particularly attractive option.

"For his part, in his State of the Union message, President Bush proposed using a portion of payroll taxes to create personal-investment accounts for American workers. I was a member of the president's bipartisan Commission to Strengthen Social Security, and I agree that personal accounts should be part of the system in the future. Critics will rightly argue, however, that creating voluntary personal accounts for younger workers will be a fiscal challenge, given the already costly obligations of supporting the baby-boom retirees.

"When it comes to strengthening Social Security, our commission acknowledged that there is no free lunch. But we also made clear in our report that tomorrow's retirees have been promised Social Security benefits much higher than those received by a retiree today with a similar work history. Accordingly, we proposed that, in the future, basic benefits be adjusted for inflation—but no more. By applying these savings, we were able to develop a reform plan that (over time) returns Social Security to financial balance, while also establishing private accounts. These private accounts represent a nest egg that younger workers can use to supplement their retirement income, leaving them better off than they would be under the traditional system.

"Several members of Congress have submitted Social Security reform plans, and bipartisan interest in reform is growing. However, as the campaign heats up, there will be a temptation by others to play politics with this issue. Voters will not be well served by scare tactics or slogans. Candidates who pledge to protect the Social Security status quo are offering a false promise. Both the GAO and the CBO have warned that meeting Social Security's future costs would require increasing payroll taxes by nearly 50 percent or reducing promised benefits by roughly 30 percent. That approach would mean that younger workers would pay more while getting less. Clearly, we need to do better than that.

"Greenspan has set the stage for an election-year debate about Social Security's future. In the final analysis, what is important to the American people are the answers to the following questions: How will benefits be paid to the retiring baby boomers once payroll taxes fall short of annual benefits? By raising taxes? By increasing debt? By an infusion of general revenues at the expense of other defense and domestic priorities? How will private accounts be financed? How will they be structured? Can we find a solution that is fair to the baby-boom retirees—while also fair to their children and grandchildren?

Penny concludes: "The answers will depend on an election-year debate that is both high profile and high caliber. Let's hope we get it."

Organizations Announce New Pro-reform Alliance

Former Representatives Jack Kemp and Dick Armey along with former Social Security commissioner Dorcas R. Hardy recently announced the creation of a new, pro-reform organization named the Alliance for Retirement Prosperity (ARP). The news release states that the new organization will "launch a campaign to promote the reform of Social Security by allowing all workers to devote to personal retirement accounts at least half of the payroll taxes they and their employers currently pay to the federal government.

The release then declares that "[t]he Alliance opposes all payroll tax increases, benefit reductions and supports prudent federal borrowing to finance transition costs (i.e., the current benefits left uncovered when part of the payroll tax is dedicated to personal accounts) involved in transforming Social Security to a fully funded, personal investment program.

"ARP will be co-chaired by Jack Kemp, Dick Armey and Dorcas R. Hardy. Steve Moore, President of the Club for Growth will serve as the National Policy Chairman. Grover Norquist, President of Americans for Tax Reform, and Charlie Jarvis, President of United Seniors Association, both members of the founders committee, also will play active roles in the coalition. Other participating organizations include the American Conservative Union (ACU), National Tax Limitation Committee (NTLC), Institute for Policy Innovation (IPI), 60 Plus Association, Small Business Survival Committee (SBSC), Coalition for Urban Renewal (CURE), Black America's Political Action Committee (BAMPAC), American Civil Rights Union (ACRU), Citizens Against Government Waste (CAGW), Center for Freedom and Prosperity (CF&P), Leadership Institute and the Discovery Institute."

Chairman Daub: Action must be taken for future workers

Social Security Advisory Board chairman Hal Daub asserts that denials of the fact that "a very serious problem exists in our Social Security system" will only allow the program's current fiscal standing to become much worse. The "panic, outrage, and distancing" following Federal Reserve chairman Alan Greenspan's call for benefit cuts were not accompanied with solutions for Social Security's financial shortfall. The lack of solutions implies inaction—an option that does not bode well for future workers according to Daub's op-ed in the *Omaha World-Herald*. Excerpts from Daub's op-ed follow:

"Today's workers need to have confidence in the program and to know what they can expect from it as they plan their future retirement. But the most thoughtful, careful, professional experts we can find have been telling us an unpleasant truth: The Social Security system is not financially sound. Yes, it currently brings in more than it pays out. But that margin is narrowing and will soon reverse, and during the retirement years of those who are now in their 20s, 30s and 40s, the program will have too little resources to pay in full the benefits that it now seems to promise.

"What will cause large and unplanned-for cuts in benefits is not action but inaction. The baby boom generation is about to enter its retirement years. The number of workers relative to the number of retirees is going to be increasingly unfavorable. The blessing of increased longevity will come at the cost of greater benefit expenditures.

"These things will not happen instantly, but they will happen. We have time to act, but we must get started now. The longer we wait, the harder the choices become and the less ability we have to find solutions that do not cause severe dislocations.

"There are many options for dealing with the problem. They are not all pleasant options, but policy-makers are not elected to have fun.

"For the past several years, the bipartisan Social Security Advisory Board has been unanimous in urging the need to act sooner rather than later. It is not the board's function to recommend a specific plan, but it has published reports detailing a wide variety of different elements that could be put together to come up with a solution.

"Nor is the board alone. There really is a broad consensus among those who study the program that it needs serious attention. A number of comprehensive plans for solving the program's problems have been put forward. These include plans that involve personal accounts and plans that do not. They include plans that involve changes in revenues, plans that involve benefit changes and plans that include both. Sponsors of these plans range across a spectrum of political inclinations.

"What is needed now is not a magic solution that pleases everyone. We all know that we will not find a magic solution. Nor may we simply decide to do nothing. The option of doing nothing is clearly and simply irresponsible. Doing nothing really means doing severe damage to our future capacity to protect the Social Security program and those who depend on it. Doing nothing virtually assures that we will forgo the opportunity to come up with a gradual approach that protects those near retirement from sudden changes that may disrupt their lives.

"What we need to do is take a fresh look at all the options and plans that are already there and find a way to work together to meld them into a compromise plan that can command broad support. That may sound like a fantasy, but we have a precedent.

"Twenty years ago, the nation faced another Social Security crisis, and a gentleman by the name of Alan Greenspan was asked to head a bipartisan commission to recommend a solution. That commission crafted its work from an array of proposals. Much of what it proposed was painful, but its proposals were adopted by what were then a Democratic House and a Republican Senate.

"All parties recognized that the Social Security program is too important to Americans to let it collapse through inaction. They also recognized that solutions need to look into the future so that drastic cuts or huge tax increases are not suddenly required."

DeMint: Individuals Should Own Their Retirement Funds

Representative Jim DeMint (R-SC) recently reaffirmed his support for personal accounts, according to a *Carolina Channel* news release. In a speech to a women's club in South Carolina, DeMint highlighted the need for action and the benefits of his proposed solution: personal accounts.

The release reports that "[DeMint] said if Congress does not act quickly, the federal government will end up breaking its promises to seniors and future retirees.

"The 4th District Representative introduced the Social Security Savings Act last year. The bill seeks to protect benefits to seniors and establish personal accounts that younger workers can own and pass on to their families.

"DeMint said individual Americans should be able to own a portion of their retirement instead of letting politicians control those funds."

Publications

The Social Security Administration has released a new policy brief entitled "The Distributional Consequences of a 'No Action' Scenario." The summary of the brief states that "[i]f no action were taken to strengthen Social Security, the benefit reductions necessitated by trust fund exhaustion would double the poverty rate of Social Security beneficiaries aged 64 to 78 in 2039." According to the brief, authored by Andrew G. Biggs, such a prediction strengthens the case for reform for younger workers who would "experience a greater reduction in lifetime benefits than older retirees because they would spend a greater share of their retirement in the post-insolvency period."

Upcoming Events and Announcements

The "2004 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds," is expected to be released on March 23, 2004. The report will present the current and projected future financial status of Social Security.

Also on March 23, the National Center for Policy Analysis will be holding an event entitled "Examining the 2004 Social Security and Medicare Trustees Reports." The NCPA release notes that the event's panel will address "two monumental shifts" scheduled to occur over the next decade: the first of the baby boomers will reach the retirement age, and Social Security and Medicare will begin to run a deficit. The panelists will include Dr. Thomas Saving, a public trustee for Social Security and Medicare, and Mr. James Lockhart III, the Social Security Administration's deputy commissioner. Together they will address the questions of "How has the new Medicare Rx drug law affected the long-term budget picture?" and "What effect do the recent trends of economic growth, employment and higher productivity have on the financial outlook of Social Security and Medicare?" The event will be held from 1:30-2:30pm at the Rayburn House Office Building in room B-318. For more information or to RSVP, please contact Matt Moore or Anna Frederick by phone (202) 628-6671 or email mmoore@ncpa.org.

On March 24, the House Ways and Means Committee will hold a hearing to discuss the report along with the findings from a report from the Boards of Trustees for the Medicare Hospital Insurance and Supplemental Medical Insurance Trust Funds. The Committee's news release states that discussion will cover the findings on "the financial status of these trust funds" and will be held at 1:00pm, at 1100 Longworth Bldg. For more information, call (202) 225-3625.

Senator Lindsey Graham (R-SC) and Representative Harold Ford Jr. (D-TN) will be panelists in a briefing entitled “Addressing Greenspan’s Challenge on Social Security and Savings: Views from an Emerging Generation of Political Leaders.” The event, scheduled for Thursday, March 25 and cosponsored by Centrists.org, will be held from 2:30pm to 3:45pm in room 385 of the Russell Senate Office Building. The official announcement asks that those planning to attend RSVP by calling (202) 986-6599 or by emailing CRFB@NewAmerica.net.

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