



Social Security Choice

SOCIAL SECURITY THIS WEEK

A WEEKLY NEWSLETTER ON SOCIAL SECURITY REFORM

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2005 Trustees Report: Problems Begin Sooner than Anticipated

The Social Security trustees released their [annual report](#) this week, which found that Social Security would begin paying more out in benefits than it takes in through taxes in 2017, one year earlier than previously expected. Additionally, the “trust fund” surpluses will be exhausted in 2041, also a year earlier than projected in last year’s report. The total unfunded obligation now stands at \$12.8 trillion. The trustees suggest that “the projected trust fund deficits should be addressed in a timely way to allow for a gradual phasing in of the necessary changes and to provide advance notice to workers. The sooner adjustments are made the smaller and less abrupt they will have to be.”

Michael Tanner, director of Cato’s Project on Social Security Choice, made the following statement about the report:

“The latest Trustees Report underscores the urgent need for substantive Social Security reform this year. The bottom line in this report is that future retirees will face steep cuts in benefits or job-killing tax increases if Congress waits even one more year. The looming crisis of the current Social Security system will deny future retirees the dignity that comes with a secure retirement.

“The only way to ensure retirement prosperity for today’s younger workers is to allow them to invest a portion of their Social Security tax into voluntary personal accounts that they would own and the government could never take away.

“This latest Trustees Report shows the government’s limits when it comes to sound management of this vital retirement program. We should give average Americans a chance to control their own future with voluntary personal accounts. They would do a much better job than the government, to be sure.

“Finally, while all the focus has been on the numbers, which can often be confusing and contradictory, we cannot lose sight of the real problem with Social Security. Under the present system, workers do not own their Social Security benefits. Personal retirement accounts will give workers ownership rights over their retirement savings.”

Washington Post: PRAs Could “Cushion” Effects of Benefit Cuts

An editorial in the *Washington Post* takes Democrats to task for failing to address the problems facing Social Security. The *Post* also praises President Bush for his willingness to tackle the issue, though they point out—correctly—that Bush has failed to address specifics. Though the editorial begins by questioning the need for PRAs, it makes the bold and accurate claim that personal accounts are not irrelevant to the debate, as many have claimed. Tackling solvency, the editorial states, will include cutting benefits—PRAs have a legitimate place at the negotiating table as a means to make those cuts less painful for retirees. An excerpt of the editorial follows.

“One can debate the merits of creating personal accounts in Social Security but not the case for fixing the program’s solvency problems. Over the next 75 years, as the Social Security trustees reported on Wednesday, the program has a projected deficit of \$4 trillion; the longer the nation waits to address this problem, the nastier the tax hikes or benefit reductions that will result. But that’s not the impression conveyed by some Democratic leaders. The trustees’ report, according to Senate Minority Leader Harry M. Reid (D-Nev.), ‘confirms that the so-called Social Security crisis exists in only one place: the minds of Republicans.’ The senator’s desire to score political points is understandable. His willingness to do so by implying that Social Security is healthy is not.

“Democrats defend this opportunism by saying the president is worse. President Bush, they complain, is talking up an alleged Social Security ‘crisis’ in order to ram through an unrelated proposal to create personal accounts. But, in addressing Social Security, Mr. Bush is taking on an issue that the Clinton administration also regarded as important; he is not inventing a problem. He can be faulted for not specifying the benefit cuts or tax hikes he favors to restore solvency, but at least he acknowledges some will be needed. In that context, personal accounts are not irrelevant; they involve risks, but they are potentially a way of cushioning the necessary benefit cuts in the traditional Social Security system.”

Poll Shows Union Workers Support Personal Retirement Accounts

A [national survey](#) released this week indicates that support of personal retirement accounts is quite high among union workers, contrary to opposition to PRAs from union leaders. Among the key findings of the survey, which questioned 600 non-retired union members:

- Seventy-four percent believe the current Social Security system is unsound and needs changes
- More than 6 in 10 think personal retirement accounts are a good idea for people under 55.
- Fifty-nine percent would take advantage of the PRA system if it were available.

- Nearly 80 percent of union workers have retirement plans apart from Social Security invested in stocks and bonds.

[Generations Together](#), a grassroots group that supports accounts-based Social Security reform, released the following statement in a press release.

“This survey clearly shows that union members have significantly different views on Social Security reform and on personal retirement accounts than do the leaders of their unions,’ said Dr. Q. Whitfield Ayres, president of Ayres, McHenry & Associates, which conducted the survey. ‘Union members believe Congress should act now to fix Social Security and a majority of union members want to start personal retirement accounts.’

“We’re not surprised to learn that union members want to fix Social Security. We meet rank-and-file union members every day who are outraged that their union is obstructing reform,’ said Derrick Max, Executive Director of the Coalition for the Modernization and Protection of America’s Social Security, which commissioned the poll. ‘Why are big labor bosses doing everything in their power to deny their members the option of personal retirement accounts when rank-and-file members clearly want to make this choice on their own?’

“This poll shows that union members are like most Americans: the more they learn about Social Security reform, the more they like it,’ wrote John J. Castellani, President of the Business Roundtable and President of CoMPASS, in a letter to John Sweeney, President of AFL-CIO.

“These results make it very difficult to understand why you are directing your members to mount protests of policies that are supported by a majority of their union colleagues. I urge you to reconsider your opposition to fixing Social Security and to advocate what is in the best interests of your members, their children and their grandchildren. Let’s work together to fix it for the workers of today and tomorrow.”

Tanner: Reform Opponents Misdirect Attention from Ownership

In a [Cato Daily Commentary](#) this week, Michael Tanner argues that opponents of reform dwell on certain aspects of the reform debate without ever making mention of the most important issue: ownership. The text of his commentary follows.

“Penn Gillette, the master illusionist, often says that there is an enormous similarity between his profession and politics. Both rely on misdirection. Politicians and magicians want you to look in one place, while the really important stuff is going on someplace else.

“To see this in action, just watch opponents of President Bush’s proposal to allow younger workers to invest privately a portion of their Social Security taxes through individual accounts. They would much prefer to debate about whether Social Security is facing a ‘crisis’ or only a ‘problem.’ They will talk about cash-flows, transition costs, and memories of the Great Depression. But the one thing they won’t talk about is perhaps the most important issue in the whole Social Security debate: ownership.

“Under the current system, once a worker pays his or her Social Security taxes into the system, the worker no longer owns that money. Most workers assume that

because they pay Social Security taxes into the system their whole working lives, they have some sort of legal guarantee to the system's benefits.

"Unfortunately, exactly the opposite is true. In two landmark cases, *Flemming v. Nestor* and *Helvering v. Davis*, the U.S. Supreme Court ruled that workers have no right to receive Social Security benefits. Congress and the president may change, reduce, or even eliminate benefits at any time. Retirees must ultimately depend on the good will of 535 politicians to determine how much money they will receive in retirement. Where is the dignity in such a system?

"As a matter of fact, Congress has already arbitrarily reduced Social Security benefits. For example, in 1983, Congress raised the retirement age. Given Social Security's looming financial crisis, additional benefit cuts and/or tax increases are certain. Further, because workers' future benefits are not guaranteed, politicians tend to make promises today that they may not be able to keep tomorrow. Therefore, the entirely political nature of Social Security puts a worker's Social Security retirement benefits at considerable risk.

"The second major problem arising from the fact that workers do not own the money they pay in Social Security taxes is that their heirs cannot inherit their accumulated retirement savings. Upon the death of the worker, no matter how much or how little the worker has paid in taxes or collected in benefits, the money he or she paid into Social Security disappears; none is passed on to his or her children or grandchildren.

"Both of these problems are solved by an individual account Social Security system. A Social Security system based on individual accounts would provide workers with the benefits and the safeguards of true ownership. Individual accounts would give all workers a true legal right to their benefits. Social Security would no longer be a political football, and workers and retirees would not have to worry that someone in Washington might cut their benefits.

"Furthermore, upon the worker's death, the money in the worker's retirement account could be passed on to his or her spouse, children, charity, or to whomever he or she wishes. With individual accounts, workers own their retirement savings!

"There is no doubt that Social Security will have to be reformed. The program will begin running a deficit, spending more money on benefits than it takes in through taxes, in less than 15 years. Overall, it faces unfunded obligations of nearly \$12 trillion.

"We can use Social Security reform to create a new, better retirement system that gives workers ownership and control over their retirement funds. We can restore Social Security to solvency, while also letting low- and middle-income workers build a nest egg of real, inheritable wealth—many for the first time in their lives. That would be a real retirement guarantee, one that couldn't be taken away at the whim of our elected representatives."

Reynolds: Investment Is Far Better than Social Security

Alan Reynolds, Cato senior fellow and syndicated columnist, takes on opponents of reform [in his column](#) this week, noting recent research by the Federal Reserve Bank of St. Louis. Reynolds's response to the criticisms of investment follows.

“Desperate critics of personal accounts, tired of being caught fibbing about actual investment experience, have switched to *hypothetical* estimates of *future* investment returns. To make these hypothetical returns as low as possible, they first assume no more than half is invested in the stock market.

“Jonathan Weisman of the *Washington Post* cites figures from Robert Shiller concerning a ‘life cycle’ account that would have only 15 percent in stocks by age 60. Since Shiller calculates that U.S. stocks have long earned 6.8 percent a year in real terms, after adjusting for inflation, while bonds earn a more variable 3 percent, any life cycle plan requiring a tiny share in stocks after middle age guarantees a low median return of only 3.4 percent. That is, he notes, ‘considerably below the 4.6 percent that the Social Security actuaries have assumed,’ because the actuaries assumed 50 percent in stocks (which is also much too low most of the time).

“Weisman neglected to mention that Shiller found, ‘Workers could do better, of course, if they eschewed the life cycle accounts and went for 100 percent stocks. In this case ... the median net account is ... 10 times as large as with the baseline life cycle account. ... Workers who choose the 100 percent stocks option lose only 2 percent of the time.’

“In 1999, when Bill Clinton was president, Shiller appeared more worried about overtaxing younger people to subsidize retiring baby boomers. ‘We should do more yet to encourage saving,’ he wrote; ‘The younger people already have their own income concerns and needs without also having to bear the burden of the risks of the retired.’

“Shiller’s figures reveal one genuine risk with personal accounts—namely, that Congress might allow people too little choice between stocks and bonds. A 50-50 stock-bond split was originally mandated for 529 college savings plans, which has now been wisely scrapped. The notion that bonds are safer than stocks is a particularly risky illusion. Indeed, Shiller’s study shows, ‘the outcome of a portfolio of 100 percent bonds is terrible. The final balance is negative 89 percent of the time.’ The value of bonds falls when interest rates rise, so investors in ‘safe’ U.S. Treasury bonds have frequently been clobbered by big capital losses.

“In the Federal Reserve Bank of St. Louis Review, Thomas Garret and Russell Rhine earned the last word on this topic. They calculate what the return would have been to those who retired in 2003 if they had instead been allowed to invest the money they ‘contributed’ to Social Security in an S&P 500 index fund or 6-month CDs. Then, they compare what retirees’ amortized monthly income would have been if payroll taxes were invested with what it actually is under Social Security. What they found was that ‘over 99 percent of the U.S. population would have earned a greater return by investing in the S&P 500, and over 95 percent would have earned a greater return by investing in 6-month CDs relative to the current Social Security system.’

“Specifically, ‘A person retiring at age 65 will only benefit more from Social Security relative to a private investment in the S&P 500 if he is a low earner and lives to

be at least 96 years old. For those retiring at age 70, the only individuals that benefit more from Social Security are low earners who live to be at least 94 years old and average earners who live to be at least 108 years old.'

"In the future, the relative payback from a lifetime of paying Social Security taxes will get much worse: 'Since those people retiring in 2003 have not always paid into the system at the current high rate of 12.4 percent, their average tax rate is only 10.7 percent, assuming 40 years of work. This average tax rate will increase in later years, as future retirees have fewer years paid in at lower tax rates and more years paid in at higher rates.'

"Whenever economists or journalists pretend that Social Security offers a better or safer return than the stock market, just remember Don Luskin's apt phrase about 'the conspiracy to keep you poor and stupid.'"

David Boaz: Let Workers Create Wealth

David Boaz, Cato's executive vice president, penned a [Cato Daily Commentary](#) this week on the benefits of allowing workers—particularly workers who don't have access to investment plans—to have personal retirement accounts funded from their payroll taxes. Boaz notes that allowing workers to invest could help shrink the wealth gap between the rich and poor by generating new wealth, rather than simply transferring existing wealth from the young to the old. His commentary follows.

"Who would benefit from Social Security reform? Opponents like to talk about a windfall for Wall Street fat cats, but that's just a red herring to divert our attention from the real issue. The real beneficiaries would be working-class and middle-class Americans.

"Right now about half of working Americans are participating in the growth of the American economy through investments in stocks, bonds, and mutual funds. But about half are not. And it's the latter half—mostly those who make less than the median income—who would benefit from Social Security personal accounts. At last they would be able to build a nest egg of their own, instead of just relying on Social Security for their retirement. And they'd have something they could leave to their children or grandchildren.

"Dramatically more Americans own financial assets now than in the recent past. As recently as 1980, only 4.6 million U.S. households owned mutual funds; by 2003 the number was 53.3 million. More than half of American families currently own stocks, bonds, or real estate. Nearly half of all U.S. households own stocks or stock mutual funds.

"But not all households are participating in the stock market. 'The majority of working Americans have not benefited directly from the rise in stock prices,' says Stephen Brobeck, head of the Consumer Federation of America. 'In fact, more than half of all households hold no stock.'

"Among people with annual household incomes of \$75,000 or more, 84 percent own stocks or stock funds; among those with incomes less than \$30,000 stock

ownership is only 26 percent. White households had an average net worth of \$468,200 in 2001, more than six times the \$75,700 of black households.

“That’s why Social Security personal accounts would mean so much to low-income families. If you make a modest income, it’s not easy to put 12.4 percent of your income into Social Security and save more on top of that.

“We should let workers up to age 55 have the option of putting their Social Security taxes into personal accounts, which they could invest in stocks, bonds, mutual funds, or other financial assets. Rep. Sam Johnson (R-Tex.) and a dozen other members of Congress propose to allow workers to divert the entire employee’s half of the Social Security payroll tax—or 6.2 percent of wages—into individually owned, privately invested accounts.

“Younger workers who chose the individual account option would receive benefits substantially higher than those that could be paid under traditional Social Security. At the same time, the plan would allow low-income workers to accumulate real wealth.

“Workers who chose the individual account option would forgo future benefits under traditional Social Security, but they would receive a bond in recognition of their past contributions to Social Security. That bond, to be cashed in at retirement age, would be calculated to provide a benefit based on accrued benefits under the current Social Security system as of the date that the individual chose an individual account.

“Under that plan, workers would build a real nest egg for their own retirement. And every worker could afford to do it. Low-income workers are already being forced to put 12.4 percent of their earnings into a Social Security system that promises them a low rate of return, and can’t even pay what little it promises. They would be much better off if they could put that money into their own account and earn a more comfortable retirement.

“A personal account would give workers more income in retirement. But more importantly, it would give them ownership, control, and inheritability. Instead of paying taxes for 40 years and then hoping that Congress would raise taxes on the next generation to pay the promised benefits, workers would have their own money in their own account, an account that would belong to them. Within some limits, they could control how the money is invested, and how they withdraw it in retirement. And workers could leave the money they had saved to their children.

“Those who worry about the ‘wealth gap’ in America should be strong supporters of personal accounts. Lower-income Americans can’t close the wealth gap unless they can save. Social Security accounts would make it much easier for them to do so.”

Events

Next Thursday, April 7, the *Washington Examiner* will host a panel discussion on Social Security featuring Rep. Patrick McHenry (R-NC). The event will be held at 8:00 AM at La Colline, 400 North Capitol Street, NW, in Washington. For more information, e-mail rsvp@dcexaminer.com.

Job Opening

The Cato Institute's Project on Social Security Choice is seeking a Social Security Policy Analyst to join our team in promoting public understanding of the benefits of allowing younger workers to privately invest a portion of their Social Security taxes through personal retirement accounts. Essential qualifications for the position include knowledge of Social Security and the issues surrounding the current reform debate. In particular, we are seeking an individual with strong analytic abilities, including knowledge of statistics and/or actuarial analysis. Successful candidates will also have demonstrated an ability to communicate to a wide public audience through writing and speaking, and a philosophical understanding and appreciation of free markets and a free society. Candidates should send a cover letter, resume, and writing samples to: Michael Tanner, Director, Cato Project on Social Security Choice, 1000 Massachusetts Avenue, NW, Washington, DC, 20001, or e-mail materials to mtanner@cato.org.

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