



Social Security Choice

SOCIAL SECURITY THIS WEEK

A WEEKLY NEWSLETTER ON SOCIAL SECURITY REFORM

WEEK OF APRIL 23, 2004

Kerry Denies Social Security Crisis

In a pair of recent interviews, presumptive Democratic presidential nominee John Kerry continued to duck tough questions about Social Security reform, denying that there is a Social Security crisis and claiming that higher economic growth alone will keep the program solvent.

Appearing on Fox News's "Your World with Neil Cuvuto," Kerry flatly ruled out a number of proposed Social Security reforms such as raising the retirement age or means testing the program. When asked directly what he would do to fix the program's finances, Kerry replied, "Strengthen the economy...if we strengthen the economy and we have a sound fiscal approach, Social Security will be strong through this century."

A few days later, Kerry appeared on "Meet the Press" and reiterated his belief that Social Security does not face a crisis. Although he opened the door a crack to means testing ("You and I earn a lot of money. We're very lucky. If you live to be 85, Tim, do you think it's right that somebody who earns \$30,000 a year after you've gotten all your money out of Social Security, after you've gotten everything and more than you paid, is paying you money?"), Kerry ultimately returned to the idea that "we don't have to cut benefits."

Although he did not address it during these interviews, Kerry had previously rejected proposals to allow younger workers to privately invest a portion of their payroll taxes through individual accounts.

On how to fix Social Security, Kerry said to Tim Russert, "We have the ability to grow out of it." Kerry said that because of his economic policies, "We're going to have a bigger economy. We'll have more Americans who are working." That will solve Social Security's problems, according to Senator Kerry.

Michael Tanner, director of Cato's Project on Social Security Choice, responded to Kerry's comments, saying, "In rejecting the warnings of Alan Greenspan, Bill Clinton, various presidential commissions, and the Social Security system's own trustees, Kerry is just plain wrong." Tanner pointed out the following facts:

- By 2018, Social Security will begin running a deficit, spending more on benefits than it takes in through taxes. The IOUs in the Social Security Trust Fund are an accounting measure, not an asset that can be used to pay benefits.
- By 2042, even on technical level, the trust fund is exhausted and, *by law*, Social Security benefits must be cut by 27 percent.
- Social Security's unfunded liabilities total more than \$11.6 trillion (on a present value basis).
- Because Social Security benefits as well as taxes are linked to economic growth, it is impossible to grow our way out of the Social Security crisis. Increased growth brings increased tax revenue but also increased benefit obligations.
- Social Security has many problems beyond its finances, including a declining rate of return for young workers, unfair treatment of minorities and working women, and a lack of property rights or ownership by workers.

"Faced with this problem," Tanner concluded, "Senator Kerry eschews leadership for political pandering. It was former president Bill Clinton who said that there are only three ways to fix Social Security: raise taxes, reduce benefits, or invest privately. Senator Kerry says he won't cut benefits or allow private investment. What then does he plan to do? Anyone aspiring to be president owes the American people an honest answer."

For more on the dangers of ignoring the problems facing the system, see "[Social Security: Is It 'A Crisis That Doesn't Exist?'](#)" by Andrew Biggs, Cato Institute Social Security Paper no. 21, October 5, 2000.

Former SSA Head Calls for Individual Accounts

Dorcas Hardy, former Social Security commissioner and also a co-chair of the [Alliance for Retirement Prosperity](#), makes a compelling case for Social Security reform and private accounts in an opinion piece published this week in *Investor's Business Daily*. Hardy takes aim at some reporters, commentators, and organizations that suggest Social Security's problems could be solved with only minor adjustments. Such careless commentary, she argues, is misleading at best. Hardy also points to one of the most critical arguments in favor of private retirement accounts: that Americans deserve the ability to make choices about their Social Security contributions, choices that cannot be made absent direct ownership of the funds. The complete text of the op-ed follows:

"On March 23, the 2004 Annual Social Security Trustees Report was released. As with every annual report, a multitude of news articles and commentaries were written about the financial status of Social Security in the weeks that followed.

"As usual, most pointed to 2042 when the 'Trust Fund' will be 'exhausted' as the ultimate day of reckoning and conclude Social Security can be made 'solvent' with 'modest' adjustments.

“The AARP, staying true to form says, ‘Social Security’s fiscal challenges can be met with modest adjustments,’ adding that ‘without any changes in current law, Social Security can pay 100% of benefits until 2041.’

“These thoughts have been echoed by other writers whose knee-jerk reaction is to oppose serious reform.

“For example, Jane Bryant Quinn in a recent piece for Newsweek, writes that ‘scaremongers’ are simply trying to shake your faith in Social Security by spreading propaganda.

Charged With Lying

“Saul Friedman takes the hyperbole a step further by accusing the Alliance for Retirement Prosperity, an organization that I co-chair, along with Jack Kemp and Dick Arme, of lying about the financial status of Social Security.

“The truth be told, Social Security doesn’t need minor adjustments, but rather needs to undergo a systemic transformation.

“Many of these writers and organizations seem to hang their hat on the line in the trustees’ report that says, ‘Projected OASDI tax income will begin to fall short of outlays in 2018 and will be sufficient to finance only 73% of scheduled annual benefits by 2042, when the combined OASDI trust fund is projected to be exhausted.’ From that line they surmise that everything will be just fine until 2042.

“However, if we look a little closer, the situation is not as benign as the AARP and some in the media would have us believe. In theory, their assessment is correct; but in reality, they are dead wrong.

Mythical Fund

“Yes, Social Security is supposed to continue paying benefits after 2018 by drawing on the Social Security Trust Fund. There is just one problem: There is no Trust Fund.

“Here’s how the system works: Surplus money now collected from payroll taxes is used to pay current retirees, and the remainder is used for other government spending. The government then writes itself an IOU for the amount spent, and those IOUs are what are commonly referred to as the Trust Fund.

“Those who argue that a system that begins running perpetual deficits in 2018 doesn’t present a serious public policy problem until 2042 are misleading readers and doing a serious disservice to the public.

“Bill Clinton put it best when he stated the options available to the government at the date of trust fund exhaustion: 1) raise taxes, 2) cut benefits or 3) get a higher rate of return through investment. The Alliance for Retirement Prosperity (arpnow.org) chooses option 3.

“That said, we believe the need to reform Social Security goes deeper than the necessity of achieving higher rates of return on investment. We think it ultimately comes down to whom do you trust with owning and controlling your retirement—yourself or the government? On this point we depart from the former president, who proposed having the government invest Social Security funds in private markets.

“Currently, you and I do not own or control our Social Security accounts in any real sense—or legally, for that matter—because the government controls those assets. This issue was addressed by the Supreme Court in *Helvering vs. Davis* and *Lester vs. Nester*, when the court ruled that Social Security taxes are simply taxes and convey no property or contractual rights to Social Security benefits.

“As a result, benefits may be reduced or eliminated by Congress at any time. And this is exactly what will happen in 2018, if not sooner, if we do not act now to reform the system. This would not be an issue if we owned and controlled our own personal retirement accounts.

“Besides, because we do not have property rights to our Social Security ‘account’ when it is controlled by the government, we have no say in how our money is invested. Nor do we have the power to bequeath our accumulated nest egg to our children or grandchildren.

Promotes Ownership

“It would be far better to transform Social Security by making use of large personal retirement accounts. This would maximize rates of return on investment, and would enhance personal ownership and control of retirement income, thereby enabling wealth accumulation among families and communities, rather than continued growth of the federal government.”

Benefits Specialist: Women Should Take an Active Interest in the Social Security Debate

In a guest column in the *Memphis Commercial Appeal*, Dorothy Sanders Wells, director of employee benefits for FedEx Corp., explores the gender gap that exists in the workplace and discovers that a wage gap between male and female workers now leads to a funding gap in retirement. Wells’s discussion of the retirement implications of the wage gap follows:

“Women also face a lower standard of living during their retirement years. Data compiled in 2003 by the Employee Benefit Research Institute (EBRI) indicate that women may be especially hard hit by the growing shortfall in retirement income. The conclusion is that unmarried women in low paying jobs are most at risk of having less than sufficient retirement income to afford basic expenditures.

America’s pension system consists of three prongs: individual savings, employer-provided retirement benefits and the Social Security system. Women may find

themselves coming up short on all three categories. First, because women earn less, they have less to set aside during their working years.

“Second, both the staff of the Joint Committee on Taxation and the Institute for Women’s Policy Research (IWPR) report that fewer women than men are covered by private employers’ retirement plans. Women often miss out on coverage because they do not work for employers that offer plans or because they work fewer than the minimum number of hours required for coverage.

“The retirement income of women covered by an employer’s plan will still fall short of that of their male peers, because earnings-based plans will provide them with fewer income dollars in retirement. IWPR reports that benefits received by women from pension plans equal only about one-half of the benefits received by men.

“Women may find themselves disadvantaged when it comes to Social Security benefits, too. The Cato Institute asserts that Social Security’s benefit structure, which was devised in an era in which single-income couples were the norm, hasn’t kept pace with America’s changing workforce demographics. Under the Social Security system, the stay-at-home wife of a covered worker will receive a spousal benefit equal to 50 percent of the worker’s retirement benefit.

“If, as is more likely today, a husband and wife are both covered workers under the Social Security system, the working wife may end up with the same spousal benefit as the stay-at-home wife if that amount is greater than the benefit she would receive based on her own earnings. She would get nothing in return for the payroll taxes that she paid into the system. [A Cato Institute report](#) contends that, due to this inequity, unmarried women and women who are part of two-income couples are subsidizing the benefits of single-income couples.

“That women tend to live longer than men completes the recipe for women’s economic disaster: With fewer resources, women are more likely to spend our advanced years in poverty. The 2000 Census figures corroborate this conclusion: More than twice as many women as men age 55 and older in the Memphis area had below-poverty-level annual income.

“These findings underscore a need for women to save more and save earlier; forgoing the new dress, jewelry or manicure today may mean a more secure future.

“Education, too, will be even more important for women striving to narrow the wage gap, since increasing competition for a decreasing number of higher paying jobs will virtually guarantee underemployment for uneducated workers.

“And no doubt Congress will be called upon to consider whether the current three-pronged retirement system affords the best opportunity for women to narrow the pension gap.

“These findings also make it clear that women can’t afford to sit on the political sidelines, especially in light of widely debated proposals for Social Security system

reform and Federal Reserve chairman Alan Greenspan's recent call to Congress to lower future Social Security benefits.

"Women have far more at stake in the Social Security reform debate: IWPR reports that Social Security benefits constitute 48 percent of the average annual income for women age 65 and older, but only 34 percent of the average annual income for men age 65 and older.

"The time has come for us to become well versed in workplace equity issues, engage in the national dialog and elect responsive lawmakers. The gender gap won't diminish our ability to hold lawmakers accountable at election time—unless, of course, we fail to vote."

For more information on the disadvantages many women face under the current system and how all women can benefit from a system of private retirement accounts, see Leanne Abdnor's "[Social Security Choices for the 21st Century Woman](#)," Cato Social Security Paper no. 33, February 24, 2004.

Ownership of Contributions Is the Missing Ingredient

Reducing benefits, raising taxes, and increasing the retirement age are all unacceptable fixes to the problems facing Social Security, according to Kansas City Star columnist Jerry Heaster. Debate on the matter misses the point, he argues, by ignoring the fact that the "money under discussion belongs to those who paid into the system." Though Heaster doesn't mention private retirement accounts in the piece, he is effectively arguing in their favor, suggesting that money paid into the system should be the property of those paying in, not the property of those doling it back out. The best way to do that, of course, is through a system of privately owned accounts in which the government can no longer fiddle with benefits at its whim. A section of Heaster's column follows:

"The most pompous of the pronouncements imply a lack of awareness that Social Security is not a government handout. We're not discussing government largesse here. Rather, we're discussing the return of money paid into the system by workers and their employers during periods that may exceed 40 years. Therefore, to talk about how best to reduce benefits equates with figuring how best to avoid returning money to those to whom it actually belongs.

"Let's look at some of the most shopworn remedies under discussion. At the top of most everyone's list is raising the eligibility age for full benefits to at least 70—the sooner the better. This is essentially an effort to call in the Grim Reaper to save the system, which is neither realistic nor honorable.

"The moral problem with this approach is that younger workers already are being taxed at an extraordinarily high level to finance current benefits. This means, all other things being equal, as economists say, it will take them longer to merely get back what they've contributed, much less receive a fair return on the investment in their retirement

years. While today's arrangement seems fair for current beneficiaries, any effort to make it more difficult for younger workers to realize a decent return borders on larceny.

"The same can be said for another favorite fix, which is raising Social Security taxes. Let's face it: It's estimated that about 75 percent of all taxpayers pay more in Social Security taxes than they do in income taxes. Further raising the Social Security tax simply makes it even more difficult for younger workers to get a fair shake when it's their turn to collect benefits.

"Given the demographic outlook for the next half century or so, there is no other conclusion to be drawn than Social Security cannot be sustained in its current form as a rational economic proposition. This is so despite all the money being invested in the system by younger workers.

"It's a challenge faced not only by America, but also by every modern society with a substantial safety net for aging populations. The inevitable outcome is that the youngest members of these societies eventually will be left holding an empty bag. But the reason pension systems such as Social Security won't be reformed radically anytime soon is that the body politic won't let it happen until there is no other option left.

"A noted economist once observed that if something can't happen, it won't. It'll take a major crisis to make America realize that Social Security as it currently exists can no longer happen. It's not a matter of if, but when. Meantime, the facile fixes being proposed will be sound and fury signifying nothing because they're politically unacceptable to most all Americans.

"When a full-fledged crisis does force change, what form might that change take? The most likely would seem a gradual transition toward a means-tested system. If it comes to this, nobody should be fooled into thinking this is the act of a benevolent government being forced to trim its social welfare spending. More precisely, it will be the most egregious act of fraud ever perpetrated against any group of taxpayers by its government."

Kemp: FICA Taxes Inhibit Personal Wealth Creation

Last Thursday, April 15, Jack Kemp, a co-founder of the Alliance for Retirement Prosperity, pointed out in a *Washington Times* op-ed that on filing day, it's important to note that "what we lack is an annual day to lament the burden of FICA taxes that come out of our paychecks every payday, depleting household savings, diminishing wealth and leaving so many totally dependant upon the federal government for retirement income." Kemp goes on to argue powerfully in favor of personal retirement accounts, a solution that would not just restore the program to solvency without requiring tax hikes, but would fix the program's other inherent problems.

"Since the inception of Social Security, payroll tax rates have skyrocketed. The tax originally stood at 2 percent. Today, the payroll tax has reached 15.3 percent. In addition, this 15.3 percent rate applies to every tax bracket, regardless of income, making it regressive, as well. As a result, for a large number of lower-income workers, many of whom have essentially been removed from the income-tax rolls, FICA taxes

loom as the greatest obstacle to personal wealth creation. Today FICA taxes contribute 33.2 percent of all federal revenues, bringing in \$648 billion to the Treasury in 2003.

“With the recent release of the 2004 Annual Trustees’ Report on Social Security, much of the debate has centered on the long-term financing of the system and the consequential effects it will have on our payroll taxes and retirement benefits. Numerous solutions have been put on the table, but most do not resolve the structural problems inherent in the system.

“Recently some Democrats have called for an immediate FICA tax cut or a payroll tax holiday. While this proposal may resonate politically, it’s disingenuous if we put their rhetoric into historical context. With a financial crisis looming, any immediate cut in payroll taxes that is not coupled with substantial reform of the current pay-as-you-go system would jeopardize the benefits of current retirees, leaving current workers and future workers with even higher taxes in the long run.

“Their proposal is disingenuous because these same politicians could have enacted these ‘reforms’ during the 1980s or early 1990s instead of raising payroll taxes, yet again, in an effort to make the system ‘solvent.’ What’s worse, the \$738 billion in surpluses (excluding interest) generated from the tax increases since 1984 and increased taxes on Social Security benefits enacted in 1993 have been wasted on other government programs instead of utilizing these proceeds to fund the transition to a fully funded personal retirement accounts program.

“The leading Democratic proposals for Social Security reform all consist of tax increases, benefit cuts or some combination of the two. And none of them offers any hope of fundamentally reforming the current system. These proposals are not politically feasible or economically rational. As the recent trustees’ report indicates, at least a 50 percent increase in payroll taxes dedicated to Social Security, a 33 percent reduction in benefits or some combination of the two would be necessary to avoid financial peril without fundamental reform.

“The AARP, formerly known as the American Association for Retired Persons, would keep the American people dependent on government, so they oppose all efforts to empower individual workers with personal accounts. They first deny any problem exists with Social Security, and when forced to admit there will be a financing shortfall in the future, they fall back on the tired and failed liberal ideology of tax and spend. One frequently heard palaver is an increase in the income cap that can be taxed for Social Security benefits.

“Former Social Security Commissioner and AARP poster boy Robert Ball supports increasing the tax on benefits to 90 percent of all earnings instead of the current 85 percent.

“It is time to transform payday from a tax event into a saving event for individual Americans. It is time to transform the FICA tax and its surpluses from a slush fund for the spending-addicted Congress into a source of wealth and prosperity for workers.

“I, along with former House Majority Leader Dick Armev and former Social Security Commissioner Dorcas Hardy, have created the [Alliance for Retirement Prosperity](#). We want to make it possible for today’s workers to move half of their payroll taxes into personal accounts that would be there for their retirement. For a single worker earning \$30,000 a year and a two-earner married couple earning \$30,000 and \$40,000 that would mean annual savings of \$2,000 and \$4,500, respectively.

“Most importantly, large personal retirement accounts would be a real source of prosperity and ownership and bring to fruition our vision of democratizing the American dream—making every American worker a shareholder and investor in our capitalistic system.”

Poll Shows Alabama Voters Support Private Accounts

A recent survey conducted by the *Mobile Register* and the University of South Alabama shows that the states’ citizens clearly see the need to reform Social Security. [The Register reports](#) that according to the poll, “a majority of Alabamians” favors changing the Social Security system. While the respondents were not in favor of reform involving government investment of Social Security revenues, they did show much support for allowing workers to invest their own payroll taxes in private accounts.

“To many Alabamians, the future of Social Security looks far from secure, but many also dislike some of the simplest options for keeping the hallowed retirement program from going broke, according to a new *Mobile Register*-University of South Alabama poll.

“Out of 407 adults queried in last week’s statewide survey, more than half believe Social Security needs major changes or a complete overhaul. In varying numbers, however, majorities oppose raising the retirement age to 70, cutting benefits for wealthier retirees or allowing the government to invest a portion of the Social Security Trust Fund in the U.S stock market.

“The one exception to that naysaying trend: 53 percent were in favor of allowing individuals to invest a portion of their Social Security payroll taxes in the stock market. Support for that option, championed by President Bush, was particularly strong among Alabamians aged 50 or younger.”

The article also discusses the low expectations most people have about the future of Social Security, noting that most respondents, particularly the younger ones, are making other plans for retirement.

“With both Republicans and Democrats hesitant to tackle the issue, many would-be beneficiaries may be adjusting their retirement plans accordingly.

“A decade ago, pollsters found that more 18- to 34-year olds believed in UFO’s than expected Social Security to exist by the time they retired.

“Among the respondents to last week’s survey, fewer than one in five adult Alabamians said that Social Security is or is expected to be their sole source of retirement income. The percentage was even lower for those aged 50 or under.

“That age group was more likely to believe that Social Security needs major changes than its over-50 counterparts. At the same time, the younger group was marginally more willing to consider benefit cuts as a way of keeping the system in business.

“Overall, almost two-thirds of the respondents preferred raising payroll taxes, compared to 18 percent who favored a reduction in benefits. Among the 50-and-under group, 59 percent preferred higher taxes, while 22 percent opted for benefit cuts.”

Chile Adds Another Retirement Option

Chile’s landmark investment-based Social Security system has added another retirement option. Previously, a retiring worker had two options: The funds accumulated in his individual account could be converted into an annuity or taken in programmed withdrawals designed to ensure income over his expected lifetime. The former option provided a guaranteed lifetime retirement income, while the latter allowed the worker to pass on an inheritance if he died prematurely. Now, however, workers may also choose an “immediate annuity with programmed withdrawals,” combining the two features. Under this option, the worker would be guaranteed an income for life; yet, if he dies early, some of his funds would still be inheritable.

In 1981, Chile successfully transformed its bankrupt PAYGO Social Security system to one based on individual savings and investment. The program has served as a model for social security systems worldwide.

For more information on Chile’s innovation in Social Security reform, see “[Empowering Workers: The Privatization of Social Security in Chile](#),” by José Piñera, Cato’s Letter no. 10, January 17, 1996.

Publications

The Center for Retirement Research at Boston College has just released two new working papers that deal with Social Security: “Lifetime Earnings, Social Security Benefits, and the Adequacy of Retirement Wealth Accumulation” by Eric M. Engan, William G. Gale, and Cori Uccello, and “The Effect of Social Security on Divorce and Remarriage Behavior” by Stacy Dickert-Conlin and Christian Meghea. Both papers can be accessed from the CRR’s website, www.bc.edu/centers/crr.

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