



Social Security Choice

SOCIAL SECURITY THIS WEEK

A WEEKLY NEWSLETTER ON SOCIAL SECURITY REFORM

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Bush Endorses Progressive Wage-Price Indexing

In a press conference Thursday night, President Bush endorsed progressive indexation to address the solvency of Social Security. The president also strongly restated his support for voluntary personal retirement accounts. From the [transcript](#):

“I believe a reform system should protect those who depend on Social Security the most. So I propose a Social Security system in the future where benefits for low-income workers will grow faster than benefits for people who are better off. By providing more generous benefits for low-income retirees, we’ll make this commitment: If you work hard and pay into Social Security your entire life, you will not retire into poverty. This reform would solve most of the funding challenges facing Social Security. A variety of options are available to solve the rest of the problem, and I will work with Congress on any good-faith proposal that does not raise the payroll tax rate or harm our economy....

“[A]ny reform of Social Security must replace the empty promises being made to younger workers with real assets, real money. I believe the best way to achieve this goal is to give younger workers the option, the opportunity if they so choose, of putting a portion of their payroll taxes into a voluntary personal retirement account. Because this money is saved and invested, younger workers would have the opportunity to receive a higher rate of return on their money than the current Social Security system can provide.”

The president expanded on his commitment to personal accounts in Q&A:

“I feel strongly that there needs to be voluntary personal savings accounts as a part of the Social Security system. I mean, it’s got to be a part of the comprehensive package. And the reason I feel strongly about that is that we got a lot of debt out there, a lot of unfunded liabilities, and our workers need to be able to earn a better rate of return on their money to help deal with that debt.

“Secondly, I like the idea of giving someone ownership. Why should ownership be confined only to rich people? Why should people, you know, not be allowed to own and manage their own assets, who aren’t the so-called investor class? I think everybody ought to be given that right.”

More on Progressive Indexation

With progressive indexation now the focus of the president's push for solvency, some reports have declared that the idea is "gaining traction" in Congress; several senators have already incorporated progressive indexation into drafts of reform bills, and Democratic senator Joe Lieberman (CT) has said that he is "interested in the idea." Below is a description from *CQ Today* of how the idea works and political reaction to it.

"Progressive indexing—the brainchild of Robert C. Pozen, chairman of the Boston investment firm MFS Management—blends price indexing and wage indexing. Pozen has suggested growing the benefits of low-income workers at the rate of wage growth. High-income workers' benefits would grow with inflation. Benefits for middle-income workers would grow at a rate between wages and inflation.

"Inflation has historically lagged behind the growth of wages by about 1.1 percent, Pozen says.

"The White House described Bush's proposal as 'a sliding-scale benefit formula similar to the Pozen approach.'

"Liberals say Pozen's plan is little better than establishing price-indexing for all workers' benefits.

"The core problem is, if you do a plan that places major weight on benefit reductions, no matter how progressive, that plan is going to have very large benefit cuts for middle-income families,' said Jason Furman, a senior fellow at the liberal Center on Budget Policy and Priorities.

"Many Democrats have said an overhaul should include tax increases, either by raising the cap on wages subject to Social Security's payroll tax or by reversing some of the tax cuts passed under Bush.

"Furman also argued in a March 21 analysis of Pozen's plan that reducing benefits for middle- and upper-income workers but not for lower-income workers would lead to Social Security resembling a welfare program, weakening its political support.

"Pozen dismissed that argument in an interview April 27, saying wealthier workers understand that Social Security must be restructured."

The arguments against progressive indexation, however, fail to take into account that the president sees it as a plan to be implemented *in conjunction with* PRAs. The change in scheduled benefits that will affect middle-income families would be offset by income from their PRAs. Additionally, political support needn't be weakened by a switch to progressive indexation. Higher-income workers will still come out ahead of currently scheduled benefits if they are able to take advantage of a large personal retirement account option.

John Tierney: Chilean System Works

The *New York Times'* new columnist, [John Tierney](#), visited a friend in Chile recently and decided to compare the (unfunded) promises made by Social Security in

the United States with the actual asset accumulations Chileans are enjoying under their system of individual accounts. Here's what he found:

"I made a pilgrimage to Santiago seeking to resolve the Social Security debate with a simple question: What would Pablo Serra do?"

"I wanted to compare our pensions to see the results of an accidental experiment that began in 1961, when he and I were friends in second grade at a school in Chile. He remained in Chile and became the test subject; I returned to America as the control group.

"By the time we finished college, both of our countries' pension systems were going broke. Chile responded by pioneering a system of private accounts in 1981. America rescued its traditional system in the early 1980's by cutting benefits and raising taxes, with the promise that the extra money would go into a trust to finance the baby boomers' retirement.

"As it happened, our countries have required our employers to set aside roughly the same portion of our income, a little over 12 percent, which pays for disability insurance as well as the pension program. It also covers, in Pablo's case, the fees charged by the mutual-fund company managing his money.

"I visited Pablo, who grew up to become an economist, at his office at the University of Chile and showed him my most recent letter from the Social Security Administration listing my history of earnings and projected pension. Pablo called up his account on his computer and studied the projected retirement options for him, which assume that he'll keep working until age 65 and that the fund will get an annual return of 5 percent (which is lower than its historical average).

"After comparing our relative payments to our pension systems (since salaries are higher in America, I had contributed more), we extrapolated what would have happened if I'd put my money into Pablo's mutual fund instead of the Social Security trust fund. We came up with three projections for my old age, each one offering a pension that, like Social Security's, would be indexed to compensate for inflation:

"(1) Retire in 10 years, at age 62, with an annual pension of \$55,000. That would be more than triple the \$18,000 I can expect from Social Security at that age.

"(2) Retire at age 65 with an annual pension of \$70,000. That would be almost triple the \$25,000 pension promised by Social Security starting a year later, at age 66.

"(3) Retire at age 65 with an annual pension of \$53,000 and a one-time cash payment of \$223,000.

"You may suspect that Pablo has prospered only because he's a sophisticated investor, but he simply put his money into one of the most popular mutual funds. He has more money in it than most Chileans because his salary is above average, but lower-paid workers who contributed to that fund for the same period of time would be in relatively good shape, too, because their projected pension would amount to more than 90 percent of their salaries.

"By contrast, Social Security replaces less than 60 percent of your salary - and that's only if you were a low-income worker. Typical recipients get back less than half of their salaries.

“The biggest problem in Chile is that many workers don’t contribute regularly to their pensions because they’re unemployed or working off the books. That’s a common situation in the developing world, no matter what the pension system is. But if you contribute for at least 20 years, Chile guarantees you a minimum pension that, relative to the median salary, is actually more generous than the median Social Security check.

“Still, you may argue, Chileans may someday long for a system like Social Security if the stock market crashes and takes their pensions down with it. The relative risks of the Chilean and American systems are a question for another column. But I can tell you that Pablo is an economist who appreciates the risks of stocks and has no doubt about where he wants to keep putting his money.

“I’m very happy with my account,’ he said to me after comparing our pensions. He was kind enough not to gloat. When I enviously suggested that he could expect not only a much heftier pension than mine, but also enough cash to buy himself a vacation home at the shore or in the country, he reassured me that it would pay for only a modest place.

“I’m not sure how much consolation that is, but I’m trying to look at the bright side. Maybe my Social Security check will cover the airfare to visit him.”

This Week in the Polls: Americans Want Choice to Invest Privately

A [FOX News poll](#) released this week finds that “fully 79 percent of the public think people under age 55 should have the right to choose between keeping all of their Social Security contributions in the current system and investing a portion of their funds. That support goes up to 84 percent among respondents under age 55.”

In terms of personal desire for the option to invest, 53 percent want the option for themselves, up from 48 percent in February. Sixty-four percent of those younger than 55 want the opportunity to invest a portion of their payroll taxes.

The poll also reinforces findings from [a survey on financial literacy](#) amongst Californians. A majority of Californians polled responded that they thought they could make better investment decisions than the government, in spite of not being overly confident in their own understanding of the stock market. In the FOX News poll, 77 percent of respondents trust themselves more than the government to make retirement decisions.

In spite of Americans’ having more confidence in themselves than in the government, [the New York Times ran an article](#) suggesting that the lack of investment savvy among most workers should halt plans for personal accounts dead in their tracks. According to the *Times*, “analysts said they thought that the findings [of a financial literacy survey] added to a growing body of evidence that the typical American is poorly equipped to take advantage of what proponents call the ownership society: a future in which individuals are free to invest their own retirement money, rather than having to accept the returns offered by the Social Security program or a group retirement program at work, like a pension plan. Many surveys have shown the public has doubts about the Social Security program, with young people, in particular, confident that they could do better by investing on their own.”

But as Donald Boudreaux, chairman of the Economics Department at George Mason University and Cato adjunct scholar, wrote [on his weblog](#), the report's conclusion is off on two counts, which he describes below.

“First, the fact that Uncle Sam has for so long assumed primary responsibility for providing for Americans’ retirement goes a long way toward explaining much of Americans’ ignorance about investing for retirement. Americans simply have less incentive to learn about such matters than we would have if each of us were responsible for our retirement.

“A person kept from ever swimming in the deepest part of the pool ought not be judged to be an inherently poor swimmer because he cannot today do more than dog paddle in shallow water.

“More importantly, the alternative to greater personal responsibility is government control—that is, strangers on the Potomac making and enforcing rules for 300 million people, each with unique histories, needs, circumstances, and hopes—not to mention risk-tolerances. How do we know that these strangers in Washington are sufficiently competent to formulate and enforce sound rules for taxing funds from each American and then ‘investing’ these sums in ways that prove wise?

“The presumed answer is that ours’ is a democracy. The wisdom of The People ensures that our government is responsive to our needs—that it generally does what’s right and wise—that it looks after us and protects us.

“Pardon the predictable question, but if Americans generally are so utterly uninformed about basic principles of personal finance and economics—if we’re such an ignorant lot—how can we be trusted to elect wise leaders? What reason is there to trust that the outcomes of elections and the policies chosen on Capitol Hill are appropriate and wise? If we’re such easy marks for scam artists, isn’t much of what government does likely to be a scam?

“The ostensible lesson of this *NYT* report, then, is that in our individual, private capacities we are benighted and irresponsible fools but that as voters and political actors we’re informed and wise enough to choose good leaders and to monitor them so that they regulate us in ways that promote our well-being.

“This is backward.

“When someone is given responsibility for his own well-being, [he is more likely to take the initiative to promote his well-being](#)—for if he doesn’t, he suffers the consequences (and, of course, if he does, he reaps the rewards). But if responsibility for my well-being is shared among hundreds of millions of voters—and then further delegated to hundreds of politicians and bureaucrats who do not know me—what reason have I to trust that these strangers will use my resources in ways that are better than I would use these resources?”

Publications

The Cato Institute has released a new Briefing Paper, “[A Better Deal at Half the Cost: SSA Scoring of the Cato Social Security Reform Plan](#).” The paper, written by

Cato's Michael Tanner, discusses the findings of the Social Security Administration's assessment of Cato's [6.2% solution](#).

The Social Security Administration has released a new issue paper by Andrew Biggs, Dave Shoffner, and Preston Jacobs entitled "[Poverty-level Annuitization Requirements in Social Security Proposals Incorporating Personal Retirement Accounts](#)." The paper takes an in depth look at the way various proposals for PRAs handle the distribution of account balances upon retirement.

The Social Security Administration has released the latest issue of its newsletter, "[International Update](#)." The publication for April looks at the most recent international developments concerning pension reform. This month's issue discusses movements toward reform in the European Union, the United Kingdom, Pakistan, Taiwan, and Canada.

The Free Market Project has issued a special report entitled "[Biased Accounts: Networks Guarantee Liberal View of Social Security](#)." The report suggests that mainstream media's portrayal of personal retirement accounts has been overwhelmingly negative, by a margin of 2-1, with four out of five networks studied supplying far more airtime to opponents of PRAs.

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