



Social Security Choice

SOCIAL SECURITY THIS WEEK

A WEEKLY NEWSLETTER ON SOCIAL SECURITY REFORM

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Armey: Private accounts will be key to Bush reelection

President Bush should make his support for allowing younger workers to privately invest a portion of their Social Security taxes a central part of his reelection campaign, according to former House majority leader Dick Armey. The former congressman offered his suggestion in a speech given at a recent Cato Institute conference on "[The Republican Revolution 10 Years Later: Smaller Government or Business as Usual?](#)" Drawing on his experience in helping Republicans seize control of Congress in 1994, Armey said:

"In order to have any kind of a political, revolutionary experience you have got to mobilize nontraditional voters. There is a block of nontraditional voters available for the President in this election that could assure his reelection and that is young adults. And, the instrument that would mobilize these people who generally are too busy flirting to go vote—the thing that the President could do to mobilize them—is a commitment to reform Social Security and give them the option to move to personal retirement accounts. That to me is the one most obvious outreach to the most quickly and easily mobilized block of nontraditional voters available before us today. And, if I were advising the President I would say, 'Don't pass this opportunity up, you very well may need it in November.'"

Cato's Rodriguez tells Senate Aging Committee America can learn from Chile's pension reform

Cato financial services analyst Jacobo Rodriguez recently testified before the Senate Special Committee on Aging at a hearing entitled "[On Strengthening Social Security: What Can We Learn from Other Nations?](#)" In his testimony, Rodriguez compared the problems faced by America's Social Security system with those faced by other pension systems around the world, primarily focusing on Chile. Excerpts from his testimony follow:

"The aging of the world's population is the result of two demographic trends. First, life expectancies at birth and at retirement have increased substantially as a result of technological and medical advances. Second, fertility rates have decreased drastically,

the result in part of economic progress and greater opportunities for women around the world.

“Although the prospects for the United States are not as severe as those for some industrialized nations of Europe and Japan, U.S. policymakers will nonetheless face daunting challenges as they seek to reform and strengthen Social Security in the context of an aging population. In the absence of any reform, Social Security will start to pay out in benefits a larger amount than what it collects in payroll taxes in 2018, according to the Social Security Administration’s own actuaries.

“Trust fund assets and payroll taxes are projected to be sufficient to pay out scheduled benefits only until 2042. My colleague Jagadeesh Gokhale, who testified before this Committee in January 2004, estimates that Social Security’s fiscal imbalance—that is, the total financial shortfall that Social Security faces—is approximately \$7 trillion.

“Fortunately for the United States, there are other countries, both industrialized and developing, that have already addressed the challenge of structurally reforming their retirement system under conditions that were similar or even more drastic than those the United States faces today.

“In 1981 Chile replaced its bankrupt pay-as-you-go retirement system with a fully funded system of individual retirement accounts managed by the private sector ... Since the Chilean system was implemented, labor force participation, pension fund assets, and benefits have all grown. Today, more than 95 percent of Chilean workers have joined the system; the pension funds have accumulated over \$50 billion in assets, a sum that is equivalent to about 67 percent of Chilean gross domestic product; and the average real rate of return has been over 10 percent per year.

“Since 1993, 10 other Latin American nations have implemented pension reforms modeled after Chile’s. Although the basic story is well known, it is worth recapping briefly. Every month workers deposit 10 percent of the first \$22,000 of earned income in their own individual pension savings accounts, which are managed by the specialized pension fund administration company of their choice. Those companies invest workers’ savings in a portfolio of bonds and stocks, subject to government regulations on the specific types of instruments and the overall mix of the portfolio.

“Through their pension accounts, Chilean workers have become owners of the means of production in Chile and, consequently, have grown much more attached to the free market and to a free society. This has had the effect of reducing class conflicts, which in turn has promoted political stability and helped to depoliticize the Chilean economy.”

To read his complete testimony, [click here](#).

William Shipman: Reform an issue of personal liberty

William Shipman, co-chairman of the Cato Institute’s Project on Social Security Choice, writes that Social Security reform may be the most important issue in the upcoming election. In an op-ed “Freedom of Choice: What Social Security Really Gets Down To,” appearing in *Investors Business Daily*, Shipman writes that the importance

of Social Security reform dwarfs that of issues discussed in the candidates' current rhetoric on foreign policy and the economy. The debate on private accounts, Shipman states, boils down to the critical issue of personal liberty.

Shipman begins: "This election is also about choosing between two overarching philosophies: Should individuals be free to choose and be responsible for their own actions, or should these liberties be the role of government? This is a big one. The stakes are high. One side will lose."

Noting the nation's current struggles abroad, Shipman notes that "[g]overnment power and authority increase during times of conflict and economic pain. And when the conflict ends, government power does not recede to its original position. As a result, the role of government advances with each new conflict.

"The Great Depression is illustrative. During this period unemployment reached 22%, the stock market virtually imploded and GDP fell by about 25%. America was on her economic knees. In response, President Roosevelt ushered in the New Deal and its flagship program, Social Security.

"Although at that time large government programs were anathema to the frontier spirit of our young nation, Roosevelt, in his first inaugural address on March 4, 1933, asked for authority '... as great as the power that would be given me if we were in fact invaded by a foreign foe.'

"From Social Security's beginning in 1935 until now the system has grown to be the largest government program in the world, paying 47 million beneficiaries each month and covering about 156 million workers.

"Yet, over its 69-year life its Depression-era financing has not fundamentally changed: Benefits are still provided by taxing workers' payrolls. Because of increasing life expectancy and falling birth rates, the number of workers per beneficiary has declined from 16 to 1 in 1950 to just about 3 to 1 today, a downward trend that is expected to continue at least through the middle of this century.

"Our government's response to these demographics has been to raise the maximum payroll tax from \$90 in 1950 to \$10,900 today. And now, for about 75% of working couples, their payroll tax is greater than their income tax.

"Under current law the payroll tax is scheduled to increase each year; tax increases are on autopilot. Even though the payroll tax has ballooned in the postwar period, future taxes are expected to be less than future benefits by about \$4.4 trillion, or \$43,000 per family. That's how much each family would have to give the government today, along with mandated rising payroll taxes, to afford scheduled benefits.

"Benefits received from paying the tax have also increased—but by less. And given that one normally receives benefits because of paying taxes, a link can be made between the two. From this perspective, one could earn significantly higher benefits by investing the same tax dollars in the growth of our economy through participating in our capital markets, just as is routinely done in employer and union-sponsored defined benefit plans as well as 401(k) plans and IRAs. Saving and investing part of the payroll tax in our markets is what is commonly called privatization of Social Security.

“President Bush, as a candidate in 2000, suggested that each American should have this opportunity. No forcing, just the freedom to make a choice. Individuals would have significantly more control over their retirement planning and decisions and, importantly, be responsible for their own actions. Government’s role would recede.

“Sen. Kerry apparently sees it differently. During the Democratic presidential primary debate in Iowa on Jan. 4, Kerry said: ‘I will never privatize Social Security.’ Compared to the Bush proposal, the senator’s statement suggests that Americans would have fewer choices, less control over their retirement planning and less freedom of choice. The government would provide, and be responsible for, much of your retirement income, and shelter you from the risk of making your own decisions. Government’s role would advance.

“What is it about a political philosophy that argues that individual behavior, choice and freedom should be the role of government? Is it because government is wiser than the individual? Is it because the individual must be protected from himself? Is it because if one were empowered to make decisions for himself and his loved ones, then the government would play a lesser role? What is it?

Shipman concludes: “As you listen to both presidential candidates express their vision for the country, consider these questions. Philosophical opponents need a playing field on which to marshal their forces and compete. The fundamental policy differences concerning the role of government versus the individual in a free society will likely be played out this election year on the Social Security reform field. The stakes, indeed, are very high. One side will lose.”

Barone: Social Security reform will lead to ‘Ownership Society’

According to Michael Barone’s column “[Ownership Society Anyone?](#)” in *U.S. News & World Report*, long-term wealth is becoming increasingly important to Americans as the nation’s economy develops into one in which wealth accumulation is possible for the ordinary citizen. Barone claims that presidential candidates have an opportunity to capitalize on this new economic feature by opening more wealth-accumulating options for Americans—the main option being Social Security reform using private accounts. Such reform would create instant asset ownership among all workers, making private accounts a potential boon for the politician who first addresses the issue.

According to Barone: “Most voters today have been living with a different economy, one in which bounteous job growth has been the norm and in which credit cards can tide you over temporary job loss. It is an economy in which the ordinary citizen over the course of a lifetime accumulates significant wealth, well into six figures today for 55- to 65-year-olds, mostly in the form of residential real estate and financial investments. It is wealth they can tap by credit card borrowing and mortgage refinancing.

“In the 1980s and 1990s, 401(k) plans and similar tax-free vehicles have helped convert America from a nation of noninvestors to a nation of investors. In 2002, about 60 percent of Americans were investors. And many of the young, who have not yet accumulated any net worth, expect to be, and will.

“For today’s economy, George W. Bush has proposed government programs that would help most Americans accumulate more wealth in the form of financial investments. The most important of these is inclusion of personal retirement accounts in Social Security, which Bush campaigned on in 2000 but has not pushed in Congress. They also include deferred savings plans in his budget this year, programs to increase homeownership and expansion of health savings accounts, a form of which were included in the 2003 Medicare bill. On occasion, Bush has referred to them together as programs designed to create an ‘ownership society,’ to help people accumulate wealth and economic independence.”

However, Barone adds, “[Bush] hasn’t sounded that theme much lately. He missed occasions like his 2004 State of the Union Address and other speeches on economic themes. Word is that the White House has had trouble making the numbers for these programs add up.

“Whatever the case, Bush risks missing the chance to be as consequential a domestic president in a second term as he has been a foreign-policy president in his first. Unless he campaigns hard for personal retirement accounts in Social Security, he will not have the political capital to get Congress to pass them in 2005 or 2006.

“Back in 1999, Bill Clinton talked about an investment component in Social Security, and leading Democrats like Sens. Daniel Patrick Moynihan and Bob Kerrey were in favor. Now, almost all congressional Democrats are against, so the votes will have to come almost entirely from Republicans, many of whom are now queasy about the idea. They won’t vote yes unless Bush makes his case for the ownership society in his campaign.”

Barone concludes: “Once again, as in 1999, we may miss a chance for government to help ordinary Americans accumulate wealth—a chance that might not come again for many years.”

Newsweek Columnist Decries Lack of Social Security Debate

In a [recent article](#) for *Newsweek*, Jonathan Darman writes that the presidential candidates’ silence on Social Security is surprising given the gravity of the program’s financial crisis. As the program’s insolvency date approaches, the financial burden it carries will rapidly increase absent significant reform. Nevertheless, Democratic presidential candidate John Kerry has had little to say about the issue, while President Bush—having previously hinted at reform with private accounts—has yet to initiate a strong push to change the system. Darman expresses bewilderment over their silence. He writes:

“Current estimates have taxpayers paying more into the system than they will receive in retirement pay by the year 2018 and the entire system rendered insolvent in the next thirty years. Even the most optimistic of politicians will admit under pressure that the large number of retiring baby boomers expecting a return on their payroll taxes could very well wreak fiscal havoc on the land. The days are dwindling before the Social Security crunch becomes a crisis but in this election year, the presidential candidates of both major parties seem reluctant to mention the problem at all.

“While the candidates’ reticence may not seem prudent considering the gravity of the issue, it could make a good deal of political sense. In the past decade, the politics of Social Security have undergone a tremendous transformation, leaving both parties uncertain exactly how to make it a winning issue at the polls. Republicans, who generally favor at least partial privatization of the system, are uneasy about pushing any program that seems to dramatically alter the 20th century’s most popular government program. Democrats, riddled with internal dissent on the proper course for fixing the system, have trouble distinguishing themselves as anything but defenders of the status quo. So while the Republicans and Democrats will no doubt get more specific on the entitlement program before 2004 is through, leaders in both parties are thinking very carefully about how much they say, [and] when.

“Once upon a time, the campaign rules on Social Security were much simpler: Democrats talked about it, Republicans did not. More specifically, FDR’s party took credit for the prizes of the New Deal program while big government-bashing Republicans tried to stay clear of American politics’ third rail. ‘For years the Republican response on Social Security was that they hoped the Democrats wouldn’t bring it up,’ Michael Tanner, a scholar at the conservative Cato Institute, told NEWSWEEK. ‘The Democrats always brought it up and then the Republican would curl up in a fetal position and talk about how much he loved his grandmother. And then they’d lose ten points in the polls and say, ‘See? Social Security’s a bad issue for us.’

“But by the late 1990s, as voters became more aware of the rough fiscal seas ahead, the consensus that Social Security was a ‘Democratic issue’ had begun to crack. Calling himself ‘a reformer with results,’ George W. Bush aggressively highlighted his plan to create personal investment accounts for Social Security savings that, he said, would promote individual responsibility and prevent the system’s financial ruin. Al Gore and the Democrats thought that they could turn Bush’s alacrity for drastic change into their own political gain. ‘There was some confidence that they could scare the Republicans off with the privatization charge,’ said Will Marshall, a Clinton administration official who heads the Progressive Policy Institute, a think tank for centrist Democrats. ‘But it didn’t really work against George W. Bush.’

“As Bush took office, many Republicans thought they had a mandate for privatization from the public. But after 9-11 and a series of high-profile corporate scandals, public approval for market-based solutions to the Social Security crisis seemed to wane. Republicans warned candidates running in the 2002 midterm elections to distance themselves from privatization plans. Democrats were convinced they could again sweep to victory as defenders of the status quo.

“Once again, however, things didn’t turn out as planned. Analysts in both parties said that in several highly watched races around the country, Democrats lost control of the debate on Social Security when their opponents pressed them to present a coherent plan. ‘The emblematic moment came in the 2002 election in North Carolina,’ Marshall said. ‘Erskine Bowles was assailing Liddy Dole for being for privatization and she held up a blank piece of paper and said, “This is my opponent’s plan for Social Security.”

“Dole went on to soundly defeat Bowles. Her campaign approach to Social Security could be a preview of Republican tactics to come. With a ballooning budget deficit and gripes from the right about his administration’s penchant for high

discretionary spending, President Bush needs to prove his bona fides with his party's fiscal conservative base. Some say a hard fight on privatization would do the trick.

"It's unclear, though, when exactly the fight will begin. In the weeks leading up to the State of the Union, conservative activists say they got strong signals from the White House that the president was going to use the speech for a major privatization push. That didn't turn out to be the case. Now the president's political advisers have promised a big policy plan in time for the fall campaign. Fiscal conservatives say they won't wait forever. 'We're not going to get excited about gay marriage and steroids,' Tanner said. 'There's got to be something there for the economic conservative side of the base.'

"Still, others in the GOP are urging caution. Remembering 2000's hard fight for Florida, they are wary of any big proposal that Democrats could frame as cheating seniors of their due. What's more, some say the Republicans risk of selling privatization as a painless fix. 'When we get in a crunch, someone is going to have to tell voters that we have to raise money to finance the transition [to private accounts],' said Robert Blendon, a professor at Harvard's school of public health who tracks public opinion on social issues. 'No poll has shown that people have any awareness of what that's going to cost.' Blendon told NEWSWEEK that when the public learns of the high cost of Republican plans to fix Social Security, public support for GOP proposals could wither away.'

"In the meantime, Democrats may be gearing up for an old school Social Security strategy, attacking any Republican plan as bad for seniors in swing states. Politically wise or not, such tactics would effectively postpone a great debate on Social Security for other candidates in other years. Marshall has concluded that such a postponement is inevitable. 'I've been saying for years that the Democrats need to get out in front on this issue,' he said. 'But when I look over my shoulder there's nobody there.'"

Chile Called Model for U.S. Reform

Jeff Benjamin's op-ed, "Chile: a model for Social Security reform," highlights Chile's successful transition from a pay-as-you-go pension program to a system of private accounts. In the op-ed, printed in *Investment News*, Benjamin points out that the success of Chile's pension system is confirmed by its positive economic results and by the efforts of other nations to duplicate these results by implementing similar reforms. The results in Chile—a country that did not have a well-developed financial services sector at the time of reform—bode extremely well for the United States, which has a long tradition of investing.

Benjamin begins: "With the major political party candidates busy spending their overflowing campaign war chests on what appears to be a solid commitment to name calling and finger pointing, you should expect the occasional sound bite related to Social Security reform.

"It has become customary in presidential campaigns to pay at least cursory regard to this massive pay-as-you-go Ponzi scheme as it rumbles toward what will likely be bankruptcy status within 15 years.

“What may not bubble to the surface, however, is the example set 24 years ago in Chile, when a 30-year-old secretary of labor named Jose Pinera engineered the successful privatization of that country’s version of Social Security.

“The Chilean model enables every worker to contribute between 10% and 20% of wages to a private retirement account that is allocated to investments through private financial institutions. Each account, which is invested according to an individual’s retirement goals, can be tracked like a passbook savings account.

“Since its inception, the program has produced an average annual return of 10.7%, nearly three times its original 4% target rate of return and about eight times the performance of the current U.S. system.

“Instead of sending money to the black hole of government, people can actually see their money,’ Mr. Pinera said, ‘and when they reach 65, instead of looking to the government, they look to their passbook.’

“Mr. Pinera, who is a co-chairman of the Cato Institute [Project on Social Security Choice] in Washington, has become a kind of international ambassador of Social Security reform.

“The idea is catching on. To date, more than 70 million people in more than a dozen countries around the world are participating in some form of privatized Social Security program modeled on the Chilean system.

“The ultimate challenge, however, remains in the United States, which operates a Social Security system that Mr. Pinera often compares to the Titanic just prior to hitting the iceberg. As he pointed out, the ability to allocate at least a portion of retirement assets into something more aggressive than U.S. Treasury bonds isn’t even the best part of the story.

“The best part, Mr. Pinera said, is getting the U.S. Social Security system out from under a government that will, in very short order, have little choice but to introduce some combination of reduced benefits and increased taxes.

“The grim reality of how the baby boomer generation’s move into retirement will inevitably push this country’s single largest spending program into deficit mode shouldn’t be mistaken for some politician’s mathematical fallacy. The fact is, the money just isn’t there. And every time another teenager puts on a paper hat for his first job flipping burgers, the liability of the system gets that much bigger.

“Mr. Pinera quiets many of the critics by explaining how the Chilean model is set up to honor all obligations to anyone receiving Social Security benefits. The system also offers voluntary participation to anyone working and paying Social Security taxes.

“Those choosing to opt out of the old system are given a ‘recognition bond’ that represents their Social Security contribution to date. There is also a government subsidy safety net for those workers who don’t meet a minimum account balance at retirement.

“In Chile, the system has linked every worker in the country to the economy,’ Mr. Pinera said. ‘It delivers a death blow to class warfare.’

“Perhaps the biggest irony to the opposition in this country to a move in the direction of Social Security reform is how well positioned our financial services industry and capital markets already are for such a transition.

“Consider, for instance, that 24 years ago, when Mr. Pinera started running weekly, three-minute television commercials to explain his idea to a working-class population, Chile didn’t even have a viable capital markets system. Compare that with the United States today, where half the population is already investing in the stock market.

“Of course this can be done in the U.S.,” Mr. Pinera said. “This is such an American idea.”

“Even though moving this country’s Social Security system toward privatization may be in the spirit of the American way, it is going to take the same kind of bottom-up support that he generated in Chile to get the job done.

“That is where financial advisers and financial services companies have an opportunity to get behind something that would have a direct effect on the industry. As Mr. Pinera discovered early on in Chile, the first step is getting the word out to those people who will ultimately be on the hook when the government can no longer send out checks.”

Ferrara: Reform could control government spending

Peter Ferrara suggests that a proposal he has made for Social Security reform could have the additional benefit of limiting the growth of federal spending. According to [Ferrara’s op-ed](#) in the *Washington Times* the legislation, proposed to help finance Social Security reform “is essential if we are to prevent the federal government from growing by more than half relative to the economy over the next generation.”

Ferrara continues, explaining that “[t]he bill’s spending limitation would reduce the rate of growth of federal spending by 1 percentage point for each of eight years. It would then allow total federal spending to grow no more than the rate of growth of gross domestic product (GDP) each year for a period.

“A forthcoming study by Empower America Chief Economist Larry Hunter, to be published by the Texas-based Institute for Policy Innovation, shows how critical this spending restraint is. The current baseline of spending growth over the next eight years is assumed in the legislation to be the rate of growth of GDP. This means the bill’s spending restraint effectively requires total federal spending to grow by 1 percentage point less than economic growth for each of the next eight years.

“As a result, after eight years, the restriction would reduce federal spending from about 20 percent of GDP today to about 18.4 percent of GDP. Mr. Hunter crucially illustrates that if the Bush tax cuts are made permanent, and the problem of the alternative minimum tax spreading from the rich to the general public is corrected, then federal revenues would also stabilize at about 18.4 percent of GDP.

“So the spending restraint proposed by the bill is exactly what is needed to balance the budget while making the Bush tax cuts permanent. Once this is achieved, the bill would stabilize federal spending along with taxes at about 18.4 percent of GDP, by limiting federal spending to grow no faster than GDP.

“The long run savings such a policy would produce would be far more than is needed to finance the transition to the Social Security personal accounts proposed in the legislation. So, after the spending restraint over the first eight years, the bill maintains its limit of spending growth to the rate of GDP growth for only five years. After that, annual spending growth is limited to the rate of growth of GDP plus 1.75 percentage points, until the transition deficits of the personal account reform plan, and all temporary debt issued to cover those deficits in the short run, are eliminated.

“This is all that is needed to complete the transition financing for the Social Security reform plan. Federal spending as a percent of GDP would be maintained at about 1.6 percentage points less than it would otherwise be for a period, until the Social Security reform’s transition deficits and debt are completely covered. This avoids the criticism from some that the modest spending limitation proposed in the plan somehow requires draconian, long-term spending reductions.

“By 2030, the spending restraint for the Social Security reform plan would have reduced federal spending by about 6 percent from the high level it would otherwise reach by then. In that year, moreover, federal spending would still be 15 percent higher as a percent of GDP than today.

“What fiscal conservatives of all stripes should target, however, is maintaining on a permanent basis the stricter spending restraint started in this reform bill. Once taxes and spending are stabilized at 18.4 percent of GDP, and spending is limited to grow no more than the rate of growth of GDP, that limit should be maintained permanently, rather than relaxed after 5 years.

“This would avoid a burgeoning, long-term federal spending crisis that few now recognize. The Congressional Budget Office projects that under current trends by 2050 federal spending as a percent of GDP would have grown to 32.8 percent of GDP, about two-thirds higher than today’s level around 20 percent.

“This massive increase in big government must be stopped. The spending limitation in the soon-to-be-introduced Social Security reform bill shows the way. If that restraint is made permanent, rather than relaxed to pay only for the Social Security reform transition, then federal spending and taxes would again be stabilized over the long run at 18.4 percent of GDP.

“The personal account reform plan in the bill will itself ultimately reduce federal spending as a percent of GDP by about 5 percentage points, as future Social Security retirement benefits would be paid almost entirely by the personal accounts rather than the federal government. The spending restraint to finance the transition would have laid the foundation for additional spending savings equal to about 1.6 percentage points of GDP.

“Federal spending would then still have to be reduced by another 7.8 percent of GDP by 2050 to keep the federal government at 18.4 percent of GDP. That would require additional reforms of Medicaid and other welfare programs, as well as Medicare.

“The main point is that this is exactly the long-term budget policy that conservatives, libertarians and free market progressives need to start fighting for now. Reform involving a large personal account option for Social Security is itself a huge issue. But the reform bill soon to be introduced actually charts the essential long-term course for the entire federal budget.”

Upcoming Events

Stephen Goss, the Social Security Administration’s long-time chief actuary will receive the first annual “Robert M. Ball Award for Outstanding Achievements in Social Insurance” from the National Academy of Social Insurance. The award will be presented at a reception at the National Press Club on June 9, 2004.

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