

# Social Security Choice

## ***SOCIAL SECURITY THIS WEEK***

A WEEKLY NEWSLETTER ON SOCIAL SECURITY REFORM

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### ***Reagan on Social Security***

Ronald Reagan was one of the earliest American politicians to recognize the need for Social Security reform. As far back as his famous 1964 speech on behalf of Barry Goldwater, Reagan said:

“We are for a provision that destitution should not follow unemployment by reason of old age, and to that end we have accepted Social Security as a step toward meeting the problem. However, we are against those entrusted with this program when they practice deception regarding its fiscal shortcomings, when they charge that any criticism of the program means that we want to end payments....”

Reagan never achieved meaningful reform. Opposition forced him to back away from tentative proposals to allow private investment, and in 1983, he endorsed the Greenspan Commission’s proposals to raise taxes and cut benefits. However, the movement to reform Social Security today, and the call for individual accounts in particular, can legitimately be said to be part of Reagan’s legacy.

### ***Wall Street Journal: Avoid “Free Lunch” in Creating Individual Accounts***

Writing this week in the *Wall Street Journal*, columnist David Wessel assails personal retirement accounts as being the solution favored by the “free-lunch crowd” of those interested in Social Security reform. After setting up the basic problem with Social Security and pointing out that the attempts of Ronald Reagan to address the problem with tax hikes and benefit cuts did little but keep the program limping along, Wessel astoundingly suggests that President Bush embrace, well, tax hikes and benefit cuts.

Wessel suggests that reforming Social Security would be a natural step for Bush, who will seek to leave the country’s finances in better order than he found them, should he win a second term. “His last State of the Union address reiterated the call to let

'younger workers...build a nest egg by saving part of their Social Security taxes in a personal retirement account.' Those economic advisers who worry, albeit very quietly, about deficits want to tackle it. All that's needed is for his political squad to say that Social Security plays well enough to make this part of the Bush legacy project.

"The problem is simple: Despite myths and trust funds, Social Security 'is not, nor has it ever been, a savings program,' Mr. Bush's point man on Social Security, Charles Blahous, wrote in a 2000 book. 'Today's payroll taxes go to support today's retirees. Tomorrow's Social Security income—at least under current law—will be provided by taxing tomorrow's workers.' The number of retirees is going to increase faster than the number of tax-paying younger workers; there won't be enough payroll tax revenue to pay promised benefits.

"Mr. Bush's first decision will be whether to pretend that permitting younger workers to divert some payroll taxes to personal accounts will suffice. It won't, and his advisers know it. Still, there is a free-lunch crowd that argues otherwise. They say these accounts will be invested in stocks and bonds, increasing saving and investment so much the U.S. will enjoy an economic boom that will produce enough additional tax revenue to pay older workers' Social Security benefits.

"That exposes one huge problem. Even if diverting payroll taxes to private accounts proves a good deal for younger workers, it leaves the government without enough money to pay benefits to existing retirees.

"If he shuns the free-lunch crowd, expect Mr. Bush to argue that markets and votes will understand an extra \$100 billion a year in government borrowing over 10 years to pay these transition costs if—and here's another big decision—it's part of a broader plan to fix Social Security finances. That'll be a particularly tough case if the deficit in the rest of the government is swollen for whatever reason.

"Making the case with a straight face demands a lasting fix to Social Security—either putting in more money by raising taxes or taking less money out by trimming benefits. Mr. Bush won't propose an increase in payroll taxes. His pattern is to throw Congress some 'principles' and hope they'll do the heavy lifting. That didn't work very well on Medicare; he got a prescription-drug benefit without much offsetting savings.

"So if Mr. Bush wants Social Security to turn out differently, he'll have to identify an acceptable way to trim spending on benefits—by changing the formula for determining how much retirees get, by changing the way benefits are increased to keep up with inflation or by lifting the age at which workers can retire and receive full benefits.

"Devising a plan that adds up is easy. Getting a plan through Congress is all that matters, and that will be hard. Compared with 1983, there are fewer members of Congress willing to accept short-term political pain to do something in their constituents' long-term interest. Many prominent politicians, Mr. Bush included, prefer telling voters that they can have costless benefits to persuading them that paying some costs now will avoid much bigger costs later.

"Mr. Greenspan's friends joke that the 78-year-old can't retire from the Federal Reserve because he won't have anything to do. Perhaps heading another commission to help Social Security age gracefully can be his post-retirement hobby."

Wessel suggests throughout his commentary that those who advocate personal retirement accounts are looking for a quick and easy fix. But those who advocate private savings understand the costs involved in the transition all too well. As discussed by Michael Tanner in a Cato Institute paper, "[The 6.2 % Solution: A Plan for Reforming Social Security](#)," there are several options for paying the upfront transition costs of moving to a prefunded system, rather than a pay-as-you-go system, and none of those solutions includes a free lunch.

### **David John: Social Security Mess Is Not the Legacy We Want to Leave Our Children**

In a [guest commentary](#) in the *Washington Times*, Heritage Foundation Senior Fellow David C. John lays out the problems with Social Security as they will apply to young Americans just starting out in the workforce. He also touches on the fact that so far in this election year, attention is inappropriately focused on trivial matters that will matter very little when compared to the \$100 billion deficits in Social Security funding that are expected to begin by 2023. John suggests in the op-ed, which follows, that personal retirement accounts will give young workers much better opportunities than the alternatives of cutting benefits or increasing spending.

"This month, my daughter Meredith graduates from high school. In the fall, she's off to college and her first real taste of independence. Unfortunately, one of the things that she faces in the real world is a bill for \$100,000 to fix Social Security. It sounds steep. But that \$100,000 is what each family in the United States will owe in additional taxes if the program is to pay full retirement benefits over the next 75 years.

"The reason for Social Security's problems is simple. Baby boomers didn't have enough children, and there will be more new retirees each year collecting benefits than there will be young people such as Meredith going to work and paying payroll taxes. Since today's Social Security benefits are paid directly from today's payroll taxes, once the ratio between workers and retirees reaches a certain level, the program will begin to run deficits.

"That's why it is time for President Bush and Sen. John Kerry to discuss this issue. Their positions on Social Security will certainly affect my family and my future. They should focus on that future rather than talk about who did what during the Vietnam War. Social Security has plenty of money available to pay full retirement benefits to everyone who either has retired or is close to retirement. This isn't an issue for senior citizens. It is an issue for Meredith and for everyone else.

"The Social Security Administration (SSA) said that starting in about 2018, the program will begin to spend more in benefits each year than it will receive in taxes. Once they start, those annual deficits will continue at least through the next 75 years, and probably well beyond that. And they will get very big, very fast. SSA said that about five years after they begin, those annual deficits will be larger than \$100 billion a year and will continue to climb after that.

"Social Security's past surpluses are gone. They were spent over the last 20 years for everything from roads to aircraft carriers. All that's left is a stack of IOUs that will have to be repaid by raising other taxes or cutting other spending. Those IOUs will be

repaid—they are in the form of government bonds, after all, and are a national promise—but it will cost more to repay the Social Security trust fund than it would to repay the entire federal debt.

“And unfortunately, that carries the program only to 2042, about 10 years before Meredith will retire. The nonpartisan Congressional Budget Office said economic growth won’t solve this problem. That means we must do something to fix Social Security or leave a growing mess for our children and grandchildren to deal with. Doing nothing isn’t an option, and each year that we delay, the eventual cost our children will have to pay goes up.

“There are only three real ways to fix Social Security: cut benefits, raise taxes or make existing taxes work harder by allowing younger workers to invest some of them in personal retirement accounts. Raising taxes or cutting benefits means that Meredith and her generation will be paying much more for much less. It’s not exactly the legacy I hope to leave my daughter. Some form of personal retirement account within Social Security at least gives her the opportunity to do better.

“As a parent, my greatest desire is to leave the world in better shape than it was when I was Meredith’s age. Social Security’s troubles threaten that goal. One of the best graduation presents we can give our children is to begin a real discussion about Social Security’s future—then make some decisions and act. Our children may not fully appreciate it now, but in a few years, it will mean much more to them than any of the presents they get for graduation.”

### **National Journal Looks at Medicare and Social Security Finances**

Writing in the *National Journal* last week, Marilyn Werber Sarafini takes another look at the Medicare and Social Security trustees reports released in March, noting that the two gigantic entitlement systems’ future obligations are unfunded to the tune of \$72 trillion. Sarfani quotes Democratic Sen. Joe Lieberman in the article, who wrote recently that “It is hard for most people to grasp those astronomical figures. They far exceed the entire net worth of the United States. But, as a nation, we must urgently grasp them—and act. Americans cannot afford to ignore this reality. Each year that we do nothing, this ‘entitlement gap’ will grow by \$2 trillion.” Though the *National Journal* piece focuses on future Medicare costs, in the following excerpt there is some discussion of the contribution that Social Security makes toward these unfunded liabilities.

“[Trustees John L. Palmer and Thomas R. Saving] have used their roles as trustees over the past few years to try to educate Congress and the public to focus more on Medicare’s broad cash-flow situation, and less on the status of the trust funds. And this year’s report is no exception. Right up front, the trustees note that Medicare expenditures were 2.6 percent of the nation’s gross domestic product in 2003. And ‘in 2006, with the implementation of the new prescription benefit, total expenditures are estimated to be 3.4 percent of GDP. The figure is expected to increase rapidly to 7.7 percent by 2035 and to 13.8 percent by 2078,’ according to the trustees’ report.

“Saving is about to release a report through the National Center for Policy Analysis, where he is a fellow, that expands on this picture. The funding deficit in Medicare this year is equal to about 3.6 percent of federal income taxes, he writes. ‘In less than five years, the share of income taxes needed will double, and five years beyond that, it will double again,’ according to Saving. By 2019, the federal government will need more than one of every four income-tax dollars to pay benefits to the elderly in Medicare and Social Security, in addition to dedicated revenues already set aside for the two programs.

“The problem worsens dramatically as Baby Boomers retire, and it doesn’t improve much after they’ve exited the programs. By 2030, about midway into the Boomer retirement years, half of all federal income-tax revenues will need to go toward deficits in Social Security and Medicare, Saving writes. And by 2070, ‘the elderly will need all federal income taxes, in addition to all payroll taxes and premium payments, leaving nothing to pay for any other federal program.’”

The entire *National Journal* article is available online at the [National Center for Policy Analysis website](#).

### ***Peru’s Privatized Pension System Called a Success***

*Pensions International*, a journal covering the global restructuring of government pension systems and its effect on financial markets, reports in its May edition that the privatized pension system in Peru continues to experience exceptional growth, 11 years after reform of the system. The brief write-up of Peru’s success from *Pensions International*, which follows, demonstrates the power of private investment in generating economic growth and stability, and is a ringing endorsement of an ownership society:

“Exactly 11 years after the first pension fund administrator—or AFP—opened for business, the system has developed from a slow-growing pool with nowhere to invest to an institutional powerhouse poring liquidity into a buoyant corporate bond market and calling the shots on state sell-offs and private sector investment projects.

“In February this year, the AFP’s helped Tractebel, the Belgian energy group, shore up US\$48 million in financing to win a state concession to finish a half-completed hydro-electrical scheme at Yuncan, in central Peru. A month later they forced ProInversion, the state privatization agency to cut by 13% the price of shares in the public sale of a state-owned stake in La Pampilla, the oil refinery just north of Lima.”

### ***Upcoming Events***

Next Tuesday, June 15, the Senate Special Committee on Aging will be holding a hearing on Social Security entitled “Strengthening Social Security: What Can Personal Retirement Accounts Do For Low-Income Workers?” The hearing will be held in the

Dirksen Senate Office Building, room 628, at 10:00 am. For more information, see the committee's website, <http://www.aging.senate.gov>.

## ***Publications***

The Social Security Administration has released its latest publication of the newsletter "[International Update](#)." The publication for the month of April looks at the most recent international developments concerning pension reform. In this month's issue, movements toward reform in Germany, Ireland, Japan, Switzerland, and the United Kingdom are discussed.

The National Center for Policy Analysis (NCPA) released a [new report](#) this week, based on findings in the Social Security and Medicare trustees report issued in March. "Social Security and Medicare benefits are on a course to crowd out funding for every other government program in the absence of changes in taxes or benefits," according to an NCPA press release. Highlights from the paper, which was written by Andrew J. Rettenmaier and Thomas R. Saving, follow:

- This year for the first time in recent history, the federal government will have to use general revenue to pay Social Security and Medicare benefits—about \$45 billion, or 3.6 percent of federal income taxes.
- The general revenue requirement as a share of income taxes will double in less than five years; and five years beyond that, it will double again.
- In 10 years, one out of every 7 income tax dollars will be needed; in 15 years, we will need one in every four.
- By 2030, about the mid-point of the baby boom retirement years, we will need more than half of federal income tax revenues to pay promised benefits.
- By 2040, we will need two of every three income tax dollars; by 2050, three of every four.
- By 2070, the unfunded deficits in Social Security and Medicare will require 100 percent of federal income taxes.

The entire report is available on the [NCPA Website](#).

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