

Social Security Choice

SOCIAL SECURITY THIS WEEK

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CBO Releases New Projection of Social Security Finances

The Congressional Budget Office (CBO) has released a [new report](#) suggesting a slight improvement in Social Security's financial outlook, but warning that the program remains unsustainable over the long term. The report, which uses more optimistic technical assumptions than the Social Security Administration, concludes that there will be slightly lower actuarial deficit and a later insolvency date than estimated by SSA. However, the report is filled with bad news for the nation's troubled retirement program.

Among the report's findings:

- Under CBO's assumptions, Social Security will begin running a deficit by 2019, one year later than estimated by SSA.
- The Social Security Trust Fund will be exhausted by 2052, ten years later than SSA projects. This is largely the result of assuming an increase in the interest rate attributed to the bonds in the trust fund. However, the report notes that "Those Trust Funds are mainly accounting mechanisms and contain no economic resources."
- Even using CBO's more optimistic technical assumptions, Social Security remains unsustainable—unable to pay promised future benefits given current levels of tax revenue. The report concludes that "unless taxation reaches levels that are unprecedented in the United States, current spending policies are likely to result in an ever growing burden of federal debt."
- The present value of the long-run actuarial deficit for Social Security is approximately \$1 trillion, compared with \$1.9 trillion estimated by SSA. "Actuarial solvency," however, is the least rigorous and relevant measure of Social Security's financial situation. For example, it does not include the cost of redeeming bonds in the Social Security Trust Fund or consider costs beyond the 75-year actuarial window. Better measures, such as "infinite horizon" projections would show a much worse fiscal picture.

- CBO achieves much of its savings by assuming lower benefit payouts in the future. That is, CBO expects Social Security to become an even worse deal for younger workers in the future.

The report does not address Social Security's many nonfinancial issues: unfairness to working women and minorities, the lack of property rights, or the drain on national savings, for example.

Opponents of Social Security reform immediately seized on the reported improvement in Social Security's finances to argue against taking action to fix the program. Robert Matsui (D-CA) said the report proves "radical reforms are unnecessary." Barbara Kennelly of the National Committee to Preserve Social Security said, "It would be absurd for policy-makers to drastically alter the program based on those numbers."

However, [Michael Tanner](#), director of Cato's Project on Social Security Choice, pointed to the report's overwhelming bad news and warned, "anyone trying to find good news in this report is simply whistling pass the graveyard."

Gokhale Critical of CBO Report

Cato senior fellow [Jagadeesh Gokhale](#), a longtime advocate of federal budget process reform, was sharply critical of the recent Congressional Budget Office Report on Social Security's finances. In this op-ed distributed to the media, Gokhale warns that CBO has underestimated the long-term problems facing Social Security:

"The Congressional Budget Office's recent report on Social Security's finances (The Outlook for Social Security, June 14, 2004-henceforth cited as 'Report') leaves a lot to be desired. The numbers cited by the report reiterate that there is a hole in Social Security's financing. Paying scheduled benefits is slated to '...require economic resources totaling between 5 and 8 percent of GDP' over the long term. However, the increase in revenues or cuts in outlays required to close the gap between them is only 0.5 percent of GDP.

"This gap appears to be small and readers may conclude that fixing Social Security's finances is no big task. However, that would be misleading. First, reporting the gap in comparison to GDP understates its size relative to the tax base from which revenues would be raised-taxable payroll. Second, a limited time horizon of just 100 years also leads to a significant understatement: Social Security's Trustees, who now report the program's financial shortfall over perpetuity, show that the post-75-year financial shortfall is twice as large as that accruing during the first 75 years. Implementing both these adjustments to the reported gap would show that closing it would require an increase in the payroll tax rate by another 4 percentage points-a nearly 35 percent increase over the current rate of 12.4 percent. The story does not end there, however. The CBO also assumes a lower unemployment rate (5.2 percent rather than the 5.5 percent used by the Trustees), a higher real earnings growth rate (1.3 percent rather than the Trustees' 1.1 percent per year) and a higher annual discount rate (3.3 percent rather than 3 percent used by the Trustees). As a consequence, and not

surprisingly, projected revenues are higher and the reported present value of the revenue shortfall is smaller than that of the Trustees. Indeed, it reveals that even after making such optimistic assumptions, there's no avoiding the conclusion that the program faces massive financial problems.

“In this light, CBO understated tone in describing the consequences of failing to reform Social Security in particular, and entitlement programs in general, is misleading. First, by emphasizing that the trust funds will cover scheduled benefit payments through 2052, the CBO implicitly suggests that no changes are needed until then. Moreover it says ‘...an ever growing burden of federal debt held by the public, ...will have a corrosive and potentially contractionary effect on the economy.’ The word ‘devastating’ would have been more accurate. Here’s why.

“First, our political system tilts toward primarily serving the interests of those who vote—the elderly. The likelihood that it will deliver, after 2052, benefit cuts of up to 30 percent in Social Security in conjunction with even more sizable cuts in Medicare benefits to a large and politically influential group of retirees is close to nil. Instead, most of the adjustment is likely to occur on the tax side—those on Gen-Xers and their kids and grandkids will shoot up to 60 or 70 percent of earnings. And that’s higher *average* tax rates. To generate the required massive tax increases under our progressive tax system, will require hiking marginal tax rates to confiscatory levels—triggering either a long-downward economic slide into oblivion or a massive economic shock and depression. This belies the prospect that the revenues required to support Social Security benefits as scheduled could ever be raised if we wait until the trust funds are exhausted.

“Second, the full long-term resource shortfall in Social Security’s finances, as estimated by the Social Security’s Trustees, is \$11.9 trillion. (The CBO, provides no confirmation or re-estimate of this number under its economic assumptions.) This would be the amount of funds the government must have in hand today, invested at interest, to make Social Security’s current laws sustainable. Not having this amount implies that the resources must be raised by hiking taxes or cutting scheduled benefits by an equivalent amount—\$11.9 trillion in present value. Second, Social Security’s financial imbalance accrues interest during each year that passes without reform. Thus, far from running a surplus of over \$100 b. each year, Social Security is really accruing an additional shortfall of \$357 billion annually (calculated at the rate of 3 percent on \$11.9 trillion), and will continue to do so until the program is reformed back to fiscal sustainability. For both of these reasons, implementing reforms earlier is more desirable—a fact that the CBO report barely suggests, leave alone emphasizes.

“Social Security is essentially a redistributive program: It takes money from one group (workers) and pays it out to another (retirees) within the same year. However, CBO’s net cash flow measure—the sequence over 100 years of revenue shortfalls relative to outlays—does not capture the redistributive impact of all policy changes. For example, the government could take more from workers each year and simultaneously provide bigger benefits to retirees in the same amounts. This would preserve Social Security’s net cash flow, but it would now be associated with a different set of economic outcomes. Under the new policy, some generations (retirees) would be made better off and others (workers and future generations) worse off.

“To deal with this shortcoming of its net cash-flow measure, the CBO has developed the capacity to evaluate lifetime benefits for different age and income cohorts. However, because its projection horizon is restricted to 100 years, it will be difficult for policymakers to receive full information about the tradeoffs involved in choosing among different policies. For example, one reform may impose huge costs well after the next 100 years but may concentrate benefits up front. Another may distribute costs and benefits uniformly over time. However, the CBO appears incapable of capturing the net impact on those alive beyond the next 100 years. Hence, our policy choices may remain biased toward those that promise gains to current generations but postpone the pain onto future generations.

“The CBO is to be commended for developing a significant capability for analyzing Social Security’s finances and reform options. Nevertheless, its fiscal measure of choice—net-cash flow over the next 100 years—is not much of an improvement over the 75-year horizon preferred by the Social Security’s Trustees. The short-term bias in policymaking is unlikely to be eliminated until new perpetuity measures are adopted and used for anchoring our policymaking process. And, given the numbers, CBO’s message on the need for Social Security reform is far from where it should be: That we ought to have undertaken reforms yesterday.”

Robert Novak: Will Bush Attempt Reform in a Second Term?

[Writing in the *Chicago Sun-Times*](#), columnist Robert Novak discusses whether or not President Bush will have the courage to take the necessary political risks to reform Social Security should he win a second term in office. And of more immediate concern, Novak wonders whether the president will campaign on the issue against presumptive Democratic nominee John Kerry. He also discusses whether Bush and his advisors will continue to frame the campaign as a referendum on the war on terror, or if they will strike out into domestic policy by campaigning on true tax reform and Social Security reform, specifically by promoting private retirement accounts. The text of Novak’s commentary follows:

“During the pause in prematurely frenetic election campaigning forced by mourning for Ronald Reagan, senior policy advisers to George W. Bush pondered two serious questions: What domestic policy initiatives should President Bush pursue in a second term? Which of those should he campaign on this year?”

“The answers will soon be debated inside the White House over how much reform Bush should risk. Political advisers are cautious and policy advisers bolder as they ponder these areas: Social Security, Medicare and taxes. Most likely, the president will advocate Social Security reform during this year’s campaign, wait for a second term to reform taxes and not venture at all into Medicare’s troubled waters.

“The broad strategic question is whether Bush should seek a second term strictly as a ‘war president’ fighting terrorism, the one area where current polls show him well ahead of John Kerry. While the political team wants to stick to the anti-terror agenda, the policy team considers it vital for the Bush presidency to confront issues that he was

expected to address in a first term but did not. These are the decisions that only Bush himself can make.

“Medicare is the issue he almost surely will forgo. Senior administration officials privately admit that last year’s prescription drug bill was a disaster substantively and politically. The golden opportunity for Medicare reform was squandered. Although the need for basic change along market-based lines persists, nobody has the will to revisit this issue any time soon.

“Social Security is another matter. The need for change is pressing, and the basic element of reform has been decided: private retirement accounts. But that will not be enough. Means-testing is needed to remove from the rolls rich old Americans who don’t need the federal stipend, many of whom long ago exhausted their contributions to the system. That change would demolish the fiction that this is a genuine insurance system rather than government welfare.

“The big political problem is cost. Transition expenses for private accounts amount to \$1 trillion over 10 years. A more radical reform, however desirable, will cost even more. The difficult argument against Democratic opposition will be that these costs eventually must be incurred by the federal government, if not now, then later.

“Bowed down by the war on terror and cautioned by conventional political wisdom to tread softly, Bush has hardly mentioned Social Security this year. But successful Republican candidates braved this supposedly lethal issue to their advantage in 2002, particularly among young voters receptive to changing a system they think will never benefit them. Bush faces conflicting advice over how much or how little he should pursue this course against Kerry.

“Tax reform is much more complicated and dangerous. When Republicans seized control of Congress in the 1994 elections for the first time in 40 years, radical restructuring of the Internal Revenue system was near the top of everybody’s list. Yet, a decade later, the GOP has not even debated—much less chosen between—a flat tax and a national sales tax. Bush ignored the issue in the 2000 campaign and throughout his first term.

“The obstacles to true tax reform, posed by both the liberal establishment and the Washington lobbying cartel, are formidable. Policy difficulties to be untangled are massive. Although the end of an intrusive tax system detested by millions promises rich rewards, no plan is ready for Bush in the 2004 campaign. It is an issue for his second term, but one that senior advisers believe he must address then.

“When President Franklin D. Roosevelt announced ‘Dr. New Deal’ had given way to ‘Dr. Win the War’ upon U.S. entrance into World War II, his historic aggrandizement of the federal government was in place. Except for his signature tax cuts, Bush’s first term has averted the risky battles required for institutional reform. The president has shown in his invasion of Iraq his willingness to take risks, and he now is being urged to do the same on the domestic level if he is elected to a second term. If he loses this election, these issues will not be addressed for another decade or more.”

GAO: Individual Accounts More Progressive Than Social Security

The General Accounting Office has released a new report concluding that a properly designed system of individual accounts could be more progressive than Social Security. *Social Security: Distribution of Benefits and Taxes Relative to Earnings Level* compared the progressivity of the current Social Security system with three proposals for Social Security reform: the Orszag-Diamond proposal, and two plans for individual accounts—Model 2 of the President’s Commission to Strengthen Social Security and a proposal developed by Peter Ferrara of the Institute for Policy Innovation.

The study concluded that Commission Model 2 would provide a greater share of benefits to lower-income workers than the current system, making the system more progressive overall. Under Commission Model 2, the percentage share of lifetime benefits received by the lowest fifth of wage-earners would increase from 12.3 percent under the current system to 14.5 percent under Model 2. The percentage of benefits received by the top fifth of wage-earners would fall from 27.4 percent to 25.9 percent.

The Orszag-Diamond proposal, which relies primarily on tax increases to balance Social Security’s finances, was also seen as resulting in a more progressive Social Security system. GAO was unable to determine the effect of the Ferrara proposal on overall system progressivity.

Whispers of a “Major Push” On Social Security Reform

“Washington Whispers,” a weekly column available on the [US News and World Report website](#), reports that the Bush team will be considering comprehensive tax reform, as well as outlining plans for a major push toward private retirement accounts during this campaign season, with hopes of solidifying and instituting that plan in a second term.

According to the column: “Second terms are all about legacy building, and plans being drawn up by the White House would make tax and retirement reform the hallmark of another four years for Dubya, insiders say. ‘These are big ideas, Reagan-sized ideas,’ says a key adviser. Already, treasury and congressional Republican leaders are considering a total rewrite of the increasingly complicated tax code, possibly junking it in favor of a European-style value-added tax or a flat tax, say officials. It’s part of a larger administration effort to find a replacement for the 1970s-era alternative minimum tax that hits about half of all Americans with added taxes. ‘That study will be the vehicle for bigger changes,’ says an administration official. Part 2: President Bush also plans a major push to let Americans put a tiny portion of their Social Security tax into personal stock accounts. But insiders say don’t look for Bush to provide any pre-election details. Instead, says one aide, the prez will use his Republican National Convention speech this summer to ‘paint his ideas in broad strokes.’”

Bush, Kerry Faulted for Failure to Address Social Security

An article by Miles Benson from the [Newhouse News Service](#) offers insight into the president's position on, and plans for, Social Security reform in his reelection campaign and his potential second term. In light of this week's CBO report, the president and his campaign staff have quickly reaffirmed the White House's commitment to partially privatized Social Security. Meanwhile, Sen. John Kerry's campaign seems to have recently realized that economic growth alone won't save the ailing system—however, Kerry maintains his earlier pledges not to raise taxes or cut benefits, leaving him with no specific plan in mind. An excerpt of the article follows:

“On Social Security, there's a clear difference between Republican President Bush and Sen. John Kerry, his Democratic challenger: Bush wants to move toward private retirement accounts invested in equity markets posing both risks and rewards. Kerry is against that change, saying that present government-guaranteed retirement benefits should not be compromised.

“But neither Bush nor Kerry is ready to disclose to voters the full range of changes in store when 76 million baby boomers retire in coming years and the system begins to run short of money.

“Most experts say the imbalances will not be erased by a shift to private accounts, nor by stronger economic growth, which is Kerry's prescription.

“A new report by the Congressional Budget Office has both good news and bad for Social Security. The bad news is that the system will indeed go broke under its current structure. The good news is that this will take longer to happen.

“The CBO said the Social Security Trust Fund will be exhausted by 2052—10 years later than the Bush administration has predicted. The CBO based its conclusions on assumptions of higher economic growth, lower inflation and higher interest rates than the administration used in its analysis. Under the CBO's projections, incoming tax revenue would be sufficient to pay 80 percent of promised benefits indefinitely.

“Bush and Kerry both vow to keep full Social Security benefits flowing without interruption but have not explained in detail how that can be accomplished.

“I personally believe the White House doesn't even want to discuss this until after the election because of the political ramifications,' Rep. Mike Castle, R-Del., told a reporters' breakfast Tuesday.

“If Bush is re-elected, the State of the Union address in January might contain a specific plan, Castle said, 'but I don't know the details of what they're thinking at all.'

“Republican leaders in Congress don't want such a dangerous issue on their hands in an election year either, said Rep. Tom Davis, R-Va., chairman of the House Government Reform Committee.

“I think our leadership has been clear that they didn't want (Bush) to send anything up at this point,' Davis said at the same breakfast. 'I assume if he is re-elected it will be an agenda item, but I could not tell you what the program is going to be. You hear a lot of things but we've seen nothing specific.'

“Kerry has been just as reticent about Social Security reform. He has specifically rejected private accounts, but he also rejects raising taxes or the retirement age or cutting benefits.

“Allison Dobson, a Kerry spokesperson, acknowledged that economic growth would not solve the system’s financing problems and represents only a ‘first step.’ What other steps Kerry would advocate are unknown.”

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