



# Social Security Choice

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

A WEEKLY NEWSLETTER ON SOCIAL SECURITY REFORM

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### ***New Cato Paper: The Cost of the Status Quo***

As lawmakers discuss the DeMint plan and the fate of the Social Security surplus, a [new paper](#) by Cato Institute senior fellow Jagadeesh Gokhale examines the tradeoff between reform and the status quo. Specifically, the paper addresses the feasibility of delaying Social Security reform, the nature of the trust fund, and the options for a long-term savings policy, and issues associated with transition to a new system and the costs involved in doing so.

“Judgments about the merits of introducing personal accounts should not be based exclusively on whether such accounts address the program’s imbalance; judgments should also be based on whether personal accounts would improve the operation of Social Security as an institution designed to safeguard (that is effectively save and invest) resources meant for financing retirement consumption. Many people who are engaged in the debate on Social Security reform apparently do not consider those indirect but important advantages of personal accounts. They also do not compare the cost of a reform that includes personal accounts....

“Options for Social Security reform must be weighed against the proper alternative—the financial implications of postponing policy adjustments. The program’s massive financial shortfall implies an annual interest cost accrual of more than \$700 billion—far exceeding growth in the economy’s capacity. If changes to Social Security policies are delayed, runaway growth in Social Security’s financial shortfall is likely to ensure higher tax rates and more adverse reactions by financial markets in the future....

“Many people today believe that the Social Security Trust Fund contains sufficient resources for paying future benefits. That explains the usual eye-widening reaction of many when (mistakenly) informed of the potential \$2 trillion transition cost of reform. Were they, instead, made aware of the \$768 billion in *annual* interest cost accruing under the current system, their response to a personal accounts reform would be much more favorable.

“An actuarially neutral personal accounts reform that replaced Social Security’s payroll tax with privately invested funds would reduce perceived marginal tax rates and improve workers’ labor market incentives. It is likely to provide workers with a stake in the economy and improve saving incentives. By revealing the existing system’s financial

imbalance, personal accounts could pave the way for an early, and therefore cheaper, adoption of additional reform measures to reduce the program's unfunded obligations. In addition, by promoting adjustments to future benefits, it would help maintain a low-tax economic environment and foster rapid economic growth."

### ***Social Security Action Rescheduled***

Citing the volume of legislative initiatives, Republican lawmakers now aim to vote on Social Security after the August recess, despite earlier hopes that progress would be made over the next few weeks. The chairman of the Ways and Means Committee, Rep. Bill Thomas (R-Calif.), [stressed](#), "There's no hang-up on contents. It's just how many days we've got."

The prospects for a vote are linked to developments with unrelated time-sensitive priorities. Critical factors include the timing of hearings for Supreme Court nominees and the fate of legislation to bring into effect the Central American Free Trade Agreement. Thomas moved quickly to dampen speculation that his prominent role in forthcoming congressional business would hinder efforts to bring Social Security to a vote on the floor, telling reporters that "some of use can multi-task."

Nonetheless, amidst the mounting weight of congressional business and with the shape of the Social Security package in the House still to be finalized, GOP leaders concluded Thursday that moves to put initial reform measures to a vote would be deferred until after the fall recess.

While the DeMint plan remains the focus of the current Social Security initiative, designed to keep Social Security surpluses within the system through new personal accounts, there is discussion over the detail of the reform package. Committee chairman Bill Thomas has been working on a broad retirement bill that would address concerns such as the retirement age. Some Republicans would prefer to proceed on an itemized basis, effecting reform through a series of initiatives. There remains a minority view that the focus should shift to solvency and examine options for tax and benefits adjustments, such as the progressive indexing model favored by President Bush.

In the Senate, Finance Committee Chairman Charles Grassley met with colleagues on Thursday to consider how to proceed. According to accounts of the meeting, several ideas were raised by committee staff while a decision on the matter was postponed. Sen. Olympia Snowe spoke afterwards, calling on Democrats to engage in the deliberations. "I think it's important to get bipartisan support for building an approach towards addressing the long-term problems of Social Security."

### ***White House Reiterates Support for Personal Accounts***

As Congress pushes back the expected vote on Social Security in preparation for a busy session, the White House has again signaled its support for personal accounts. Though unwilling to publicly demur from congressional moves based on the DeMint plan, reports indicate that the president remains committed to more substantial personal accounts as part of a comprehensive reform package. According to *Congress Daily*, the president's preferred plan would see the creation of personal accounts funded with 4 percent of payroll taxes.

Deputy Chief of Staff Karl Rove met recently with Republican leaders to discuss the shape of future measures. Rove later traveled to Nebraska, where he addressed the issue before a local business group. The presidential aide criticized proposals to resolve the solvency crisis through tax increases, stating that increased taxes would delay, rather than avert, the point at which bankruptcy is reached. Rove also stressed the urgency of reform, arguing that the nation could no longer wait to stave off Social Security insolvency, adding, "Time is our friend today. We're going to get to the point where time is our enemy."

The president's position was praised by FreedomWorks:

"While GROW accounts [created from the surplus alone] are a step in the right direction for Capitol Hill, the larger accounts President Bush are calling for are even better. Larger PRAs more quickly convert Social Security financing from the curse of compounding debt to the blessing of compounding wealth."

### ***Social Security Official Praises Bush Accounts Idea***

James Lockhart III, deputy administrator of the Social Security Administration, spoke this week about the various proposals to reform Social Security. Lockhart began by stating the view that any solution to the crisis must put the system on a secure long-term footing:

"Social Security is looking at all the alternatives (but) one of our strategic goals is achieving sustainable solvency which means going beyond just the next 12 years and trying to fix this permanently."

The administration has campaigned for reform centered on the option of personal accounts for younger workers. This would allow individuals to build up substantial retirement funds, whereas the DeMint plan, the basis of current congressional initiatives, is limited to safeguarding the Social Security surplus until it runs out in 2017. Lockhart expressed his support for the president's ideas, notwithstanding the fact that a complete proposal is yet to be stated. "[President Bush's proposals] go a long way down the road to a permanent fix. We will certainly be supporting the president... And I believe in what he's doing to fix Social Security."

Turning his attention to the role of personal accounts, the Social Security official, who spoke at length on the nature of the looming financial crisis, said, "I believe that, properly structured, personal accounts have a significant role to play".

The latest [paper](#) in the Social Security Choice series, authored by Cato Institute senior fellow Jagadeesh Gokhale, similarly emphasizes the pressing need for reform to avert the financial crisis:

"Some commentators are suggesting that there is no need to change policies until 2041 because the current system can finance scheduled benefits fully until then under current laws. Were we to follow such a course, however, the payroll tax hike in 2042 would have to be more than 5 percentage points—taking it from 12.4 percent to 17.5 percent in order to continue paying benefits forever under current eligibility and benefit formulas. That is, delaying reform until 2041 would reduce the tax bite on today's generations and workers until that year but would increase the payroll tax rate for workers after 2041. That implies a large shifting of fiscal burdens from the present to the

future, or, what is the same thing, a redistribution of resources from the future to the present with attendant negative consequences for future economic growth.”

### ***Featured Daily Debunker***

With Congress due to consider two bills based on the DeMint plan, which stops the annual flow of Social Security surpluses into unrelated spending, Wednesday’s *New York Times* ran a perfect illustration of why critics who argue that the proposal fails to sort out long-term Social Security solvency are missing the point. Tucked away in an [article](#) in the business section discussing the future size of the deficit is a crucial admission:

"Social Security’s annual surpluses, which have been running around \$150 billion a year, have been a major source of operating cash for the government. But those surpluses will start to decline before the end of the decade, and the program is expected to start running annual deficits in 2017".

That's the little secret about Social Security that doesn't get enough attention.

Until 2017, the system will run annual surpluses, meaning that workers are paying in more than comes back out in benefits. The surplus generated each year should be saved for Americans’ retirements, but instead Congress spends it on whatever it wants. That’s where the DeMint plan steps in. Under the provisions of the DeMint bill and the GROW plan in the House, Congress will no longer be able to dip into the trust fund, and the surplus will be dedicated to personal retirement accounts for workers who provided that revenue in first place.

The *New York Times* makes clear the effect of the raid on Social Security. If Social Security and America’s retirement security is the first casualty, fiscal transparency is the second. With no check on how the surplus is spent, budget-setters have been using the full \$150 billion to mask the size of the overall budget deficit. As the *New York Times* puts it, the surplus has been “a major source of operating cash”. In other words, Congress has increased government spending by reaching over to Social Security whenever it runs low on funds. That’s a bit like meeting your mortgage payment by raiding your savings and then convincing yourself that your savings is still there.

It's time to stop the raid on Social Security.

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