

Social Security Choice

SOCIAL SECURITY THIS WEEK

A WEEKLY NEWSLETTER ON SOCIAL SECURITY REFORM

WEEK OF JULY 30, 2004

Democratic Platform Silent about Social Security Fix

The platform approved by this week's Democratic National Convention opposes Social Security "privatization" or any reduction in Social Security benefits, but says nothing about how Democrats would deal with the program's looming financial crisis. The platform reads:

"We are absolutely committed to preserving Social Security. It is a compact across the generations that has helped tens of millions of Americans live their retirement years in dignity instead of poverty. Democrats believe in the progressive, guaranteed benefit that has ensured that seniors and people with disabilities receive a benefit not subject to the whims of the market or the economy. We oppose privatizing Social Security or raising the retirement age. We oppose reducing the benefits earned by workers just because they have also earned a benefit from certain public retirement plans. We will repeal discriminatory laws that penalize some retired workers and their families while allowing others to receive full benefits. Because the massive deficits under the Bush Administration have raided hundreds of billions of dollars from Social Security, the most important step we can take to strengthen Social Security is to restore fiscal responsibility. Social Security matters to all Americans, Democrats and Republicans, and strengthening Social Security should be a common cause."

Democratic nominee John Kerry echoed those sentiments during his acceptance speech, declaring, "I will not privatize Social Security. I will not cut benefits." Exactly what he *would* do remains unknown.

Yet, Social Security will begin running deficits in less than 15 years, spending more on benefits than it takes in through tax revenues. Overall, the program faces more than \$26 trillion in unfunded liabilities. As former President Bill Clinton pointed out, there are really only three options for Social Security reform: raise taxes, cut benefits, or invest privately. Since both Kerry and the Democratic platform rule out private investment or benefit cuts, they could be

accused of implicitly endorsing tax increases. On the other hand, they could also be said to have ducked the entire issue.

A Democrat Makes the Case for Private Accounts

Robert Hanson, a member of the New Democrat Network, argues passionately in Dailypress.com for the Democratic Party establishment to endorse private Social Security accounts. By challenging Democrats to recall the promises of Social Security as President Roosevelt articulated them, Hanson urges politicians from all parties to embrace personal accounts as a means of establishing solvency for the system. He concludes that such a system will especially benefit low-income Americans, offering them “optimism, opportunity, and prosperity” in their financial futures. The full text of his commentary follows:

“As a lifelong Democrat, I am concerned that the Establishment Democratic Party in Washington has allowed partisanship to eclipse its good sense of policy. Nowhere is this tendency more observable than with respect to reforming Social Security. Conceived by President Franklin D. Roosevelt, the principle of government intervention to promote retirement security has been remarkably enduring in the minds of all Americans.

“In politics as in nature, however, species that do not adapt to changing circumstances do not survive. Today, lower birth rates and higher life expectancy are creating a demographic pincer that will soon squeeze Social Security with such force that it will collapse in upon itself if something isn’t done to prevent it. Changing demographics are leading to a rapidly decreasing ratio of workers to recipients, which Roosevelt could not have foreseen. This trend portends an unsupportable, unfunded liability for the pay-as-you-go system beginning in the near decade.

“Yet, sophisticated, contending proposals to avert a solvency crisis and to remediate what have become pitifully small benefit payments have not flooded the marketplace of ideas. In fact, Establishment Democrats are reacting to this looming financing crisis as if it is Social Security ‘as we know it’ that must be maintained in near pristine form lest the Rooseveltian principle on which it was erected be abandoned.

“Nothing could be further from the truth. To preserve the enduring New Deal principle, the existing application of the principle must be transformed to meet 21st-century challenges.

“Meeting 21st-century policy challenges will present new-found political challenges for Democrats to overcome. For example, the dominant theme that runs through Washington Democratic thinking continues to be ‘protecting’ the little guy against the vagaries of life and ‘defending’ average Americans against the rich and powerful. But moderate- and low-income Americans, women and minorities are looking for more than security. They believe increasingly that their success in life does not depend upon taking something from someone else. Therefore, the traditionally dour political message must be elevated by a new Democratic message of optimism, opportunity and prosperity.

“President Bill Clinton fully understood these facts, as was evident when he said, ‘Social Security was conceived as giving a floor for life. It is not enough to sustain the standard of living of almost any retiree retiring today.’

“With Clinton gone, simplistic statements substitute for thoroughly thought through plans. Increases in payroll taxes, cuts in benefits, hikes in the age for benefit eligibility and introduction of a means test illustrate the bathos of banalities by policy makers and advisers who are bereft of real substantive ideas of how to transform the program to preserve the principle.

“The most serious reform proposal to date is personal accounts, a refinement of Roosevelt’s program. Basically, under personal accounts, workers could allocate up to half of their payroll taxes into a structured and controlled private investment fund. Opportunities for greater returns from private investment redound to all workers, but especially lower income workers.

“Through personal accounts solvency in Social Security is achieved because the government is bearing only half of the burden of returning taxes back to workers in benefit payments. Reducing the government’s share will permit Social Security to be funded fully in perpetuity beginning only a few years after personal accounts are put into place. Retirement income to individuals should increase appreciably. Stock market investments beat traditional government-based rates of return to recipients, including their most dismal 20-year period of performance and the last three years of limited economic growth.

“Rooseveltian principles can be maintained and, in fact, enhanced progressively with personal accounts. Let us all hope one party emerges with a clear, comprehensive and convincing reform agenda for Social Security.”

Ramesh Ponnuru on the Competing Reform Bills

Writing on *National Review Online*, Ramesh Ponnuru discusses the two competing Social Security reform bills—one introduced by Rep. Paul Ryan (R-Wis.) and the other by Reps. Sam Johnson (R-Texas), Jeff Flake (R-Ariz.), and Pat Toomey (R-Pa.)—and looks at how each bill might fare in the House and with the public. Though both are based on large private accounts, Ponnuru writes, the two bills have distinct features that are worth noting. His full discussion of the bills and their possible political ramifications follows:

“In 2000, then-Gov. George W. Bush introduced the idea of letting workers invest some of their Social Security funds into presidential politics. This year, however, he has been less vocal about the issue, largely out of deference to House Republican leaders who worry that reform is a vote loser.

“Now some congressmen are stepping forward to make it clear that not everyone in the House Republican conference is afraid of the issue. Rep. Paul Ryan (Wisc.) introduced a private-account bill this week. Another one was introduced by Sam Johnson (Tex.), with Reps. Jeff Flake (Ariz.) and Pat Toomey (Penn.) as cosponsors.

“Toomey and Ryan both say that the bills are part of a joint effort with two goals. The first is to demonstrate strong House Republican support for private accounts by getting as many co-sponsors as possible. ‘Every Republican should feel comfortable cosponsoring one or the other or both,’ says Ryan. The second is to move the debate among reformers to large accounts. Both bills would allow people to invest, on average, 6.2 percent of their wages, which is most of the portion of the payroll tax that shows up on pay stubs. Previous bills, notably the one sponsored by Jim Kolbe (R., Ariz.) and Charles Stenholm (D., Tex.), have allowed a much smaller level of private investment.

“The assumption behind those earlier bills was that smaller accounts would be easier to get through Congress. Letting workers invest two percent of their wages would be the cautious, incremental, toe-in-the-water approach. Also, the immediate budget impact of the accounts would be smaller. Private accounts do not increase the Social Security system’s total obligations to current and future retirees. But private accounts do shift some of those obligations forward in time—and the larger they are, the more that is true.

“The new bills work off different assumptions. The large-accounts people argue that workers will not be interested in the accounts unless they can put significant amounts of money in them—and thus accumulate money faster. ‘It’s large accounts that really allow you to transition to a system that really becomes entirely funded through personal savings,’ says Toomey. ‘It allows you to get away from the dependency of this transfer system that we have in place now.’ Ryan concurs: ‘It more quickly gets people into the business of being capitalists.’

“There are some significant differences between the two bills. The Ryan bill is based on the plan of longtime Social Security reformer Peter Ferrara. It recognizes workers’ past contributions to the system by paying them back a percentage of what they put in. It has a progressive feature: lower-income workers will be able to invest a higher percentage of their wages than higher-income ones. It attempts to deliver all the benefits promised by current law to future retirees. It pays for the program’s existing shortfall, and the financing costs of creating the accounts, by cutting domestic spending.

“The Johnson-Flake-Toomey bill, on the other hand, is based on the work of the Cato Institute. It issues workers a negotiable bond reflecting the value of their past contributions. They can start their accounts with the proceeds from the sale of that bond. This bill lacks the Ryan’s bill’s progressive feature. And it is financed by reducing the growth of benefits—although everyone would be guaranteed benefits worth at least 125 percent of the poverty level.

“Neither side is criticizing the other much, but both camps think their bill makes more political sense. Rep. Ryan argues, ‘The point I’m trying to make is we need to have a reason for controlling spending beyond that it’s a good thing to do. I like the idea of showing people that there’s a tremendous benefit to getting spending under control: a large private account in your name. At the same time, we maintain a very important political point: We’re not going to cut your Social Security benefits. Philosophically, I would rather send more money in checks to citizens, which is the least inefficient kind of

program the government can run, than to the National Endowment for the Arts or some other government bureaucracy.’

“Rep. Toomey, on the other hand, argues that because the bill he is co-sponsoring would make it possible for workers to have large balances in their accounts on day one—from the proceeds of the bond—it would be more appealing. ‘They’re invested financially and psychologically in the reform from day one with a really meaningful amount of savings.’ He also thinks that high-income workers will prefer this plan precisely because it is not progressive. Here’s what he says about the question of funding: ‘I want to be very complimentary of Ryan’s bill; I think it’s very constructive. The [budget] scoring of this bill should not reflect changes in law that are outside the Social Security system. I am a big supporter of [general] spending restraint, but it has nothing to do with Social Security reform.’ Toomey does not worry about facing the charge of ‘cutting benefits,’ he says. ‘It’s promised benefits and most Americans understand that the system is not capable of delivering on those promises.’

“Grover Norquist, the well-known conservative activist, is a friend to both camps. He thinks that it is helpful to start a discussion about large accounts—but worries that it might not be helpful to start that discussion at the same time as the differences between the bills draw attention to the question of financing reform. Above all, he hopes that the president will return to the theme of Social Security reform during the Republican convention. On that point, Ryan, Johnson, Flake, and Toomey concur.

Scott Burns: Faulty Assumptions Hamper the Social Security Debate

Writing this week in the [Dallas Morning News](#), columnist Scott Burns takes a look at the faulty assumptions behind the overly optimistic outlooks of some economists and politicians on the future of Social Security. Using the “intermediate cost assumptions” provided by the trustees, he argues, didn’t work when planning the reforms to Social Security in 1983, and they won’t work now. The result of using the higher-but-more-realistic cost assumptions, according to Burns, is that Social Security may be in trouble much sooner than expected. An excerpt of his article follows:

‘Book’ money vs. cash

“What happens if we ask when the actual cash payments to beneficiaries will exceed the actual cash revenue from employment taxes? I ask this question because all the other money is ‘book entry’ money. It records obligations, not actual cash. Actual cash is required to make payments.

“Answer: We may be in trouble as early as 2010.

“This figure comes from the trustees of Social Security and Medicare. They’ve done the cash analysis for us. The figures are available on the Web in a table titled ‘OASDI and HI Annual Income Excluding Interest, Cost and Balance in Current Dollars.’ Basically, it’s a cash-flow analysis of the Old Age Security and Disability Income programs and the Hospital Insurance program of Medicare.

“Since the analysis involves estimates from 2004 to 2080, the trustees give us three sets of figures. One is for ‘intermediate cost assumptions.’ These are the assumptions about economic growth, employment growth, birth rates and death rates that the trustees believe most likely. They also provide tables for ‘low cost assumptions’ and ‘high cost assumptions.’

“In the intermediate assumptions table, OASDI shows a cash surplus of \$64 billion for 2004, and Hospital Insurance has a \$3 billion shortfall. With rounding, that nets to a comfortable \$62 billion surplus.

“By 2018, OASDI turns negative, just as Commissioner Barnhart warns. When combined with Hospital Insurance, the first negative year is 2016.

“That’s pretty far away.

“But check the ‘high cost assumptions.’ They tell us that OASDI will be short of cash by 2013. The combined programs will be cash-short by 2010.

“That’s six years away.

“Being cash short for Social Security and Medicare benefits wouldn’t be worrisome if our friends in Washington were enjoying revenue collections beyond their wildest dreams. But they are not. They’re looking at deficits from here to eternity. They won’t be able to tap general revenues because general revenues will already be thoroughly tapped.

“If George W. Bush is re-elected president in November, he’ll be very glad a third term isn’t possible. If John Kerry is elected, he’ll be the first president delighted to have only one term. Whoever is elected president in 2008 will be known in history as ‘the fall guy president.’

“Query: Which set of assumptions is more likely, the intermediate cost, the low cost or the high cost?

“Politicians of both parties will tell you the intermediate cost assumptions, because that puts the problem further into the future. In fact, the high cost assumptions are more likely.

“This isn’t a matter of inflammatory journalism. It’s a matter of history.

“When Social Security was reformed only 20 years ago, you and I were told that the higher taxes and higher retirement age would make it fully funded and financially sound for 75 years or more. Today, only two decades later, the Social Security trustees tell us OASDI has unfunded liabilities of \$3.7 trillion.

“What happened?

“The high cost assumptions turned out to be more accurate than the intermediate cost assumptions.”

Time for Pension Reform in Ireland

An article in the August 3 edition of *Business and Finance* magazine by Constantin T. Gurdgiev argues that the time for pension reform in Ireland has arrived. Like much of the rest of Europe, Ireland will be facing huge demographic changes over the coming decades that will make traditional PAYGO pension systems unsustainable as there are increasingly more retirees than workers. Gurdgiev argues that a system of private savings, like the one designed by José Piñera in Chile, will “prove to be a potent source of productive labour in ageing Europe.” An excerpt of the article follows:

“In the last few weeks we’ve heard it all—shaken by the local elections, the Government is no longer willing to ‘allow unbridled market forces shape our country’ according to Minister D. Ahern. Regardless of whether or not Ireland Inc. was ever shaped by the unbridled market, the Government has failed to address the shortage of the pro-poor growth policies. Yet, at least in one extremely important area there is a possible reform that can achieve significant economic gains while empowering the low earners in building their prosperity. That area is pay-as-you-earn (PAYE) pension system.

“The urgency of the Irish pension reform cannot be overestimated. By 2025, the EU labour force can shrink by as much as 10%, placing an unbearable burden on the welfare states with PAYE pensions provisions. Over the last 30 years, population growth and changes in the labour force participation accounted for roughly 2/3 of the GDP growth in the OECD. With these sources of growth exhausted, the EU welfare states will be unable to pay even funded pension benefits, while economic growth will be held back by more than 1 percentage point. The resulting economic crisis can be exacerbated by the Japanese-style tax-induced recessions. The poor and the middleclass will have to bear the burden of the reckless welfare-state promises disproportionately more than the wealthy and the bureaucrats.

“Despite Ireland’s slightly more favourable demographics, the opponents of reforms are missing the point. As a small open economy, Ireland will be unable to insulate itself from the EU-wide shocks under the current pensions system. In addition, the Government’s 1% of GDP contribution to funded pensions is failing to close the pensions gap in the public sector alone.

“To ensure our prosperity through the demographic storm, we urgently need a meaningful reform of our pensions policies. A successful example of such reform is offered by Chile, which in 1980 replaced the PAYE-type entitlements with the privately administered system of Pension Savings Accounts (PSA). According to Dr. José Piñera, the pension reform architect, within 23 years of operation, the system based on voluntary participation attracted more than 95% of Chilean workers, increased the national savings rate to 27% of GNP and helped push economic growth to 6.5% per annum. More importantly, the PSA system closed the country’s pensions gap.

“Dr. Piñera outlined the structure of reforms during his speech in Dublin at the *Open Republic Institute*. The core idea behind the PSA is that neither the worker nor the employer are charged social security tax by the state. Instead, the state requires that each employee deposit 10% of her wages in the individually owned PSA. This applies only to the first \$22,000 of annual income, so that as economy expands, pensions

provision costs fall. To encourage greater savings, an employee may contribute an additional 10% of her wages tax-free.”

Publications

In a recent edition of the magazine *Tax Notes*, a publication of [Tax Analysts](#), Brian Jenn and Donald B. Marron argue that despite the claims of individual account opponents, repealing the 2001 and 2003 Bush tax cuts would not provide enough revenue to solve Social Security’s long-term funding problems. The article, “The Long-Run ‘Cost’ of Tax Cuts,” looks at current calculations about the future costs of the tax cuts and “finds them flawed and misleading. The long-run ‘cost’ of extending the tax cuts,” they continue, “is not remotely comparable to the long-run fiscal imbalances in Social Security and Medicare.”

Upcoming Events

The Committee for a Responsible Federal Budget at the New America Foundation will be hosting a panel discussion next week entitled, “How to Fix Social Security: Comparing the Different Approaches to Reform.” Douglas Holtz Eakin, the director of the Congressional Budget Office, will provide background on the problems facing Social Security before advocates of various reform proposals discuss their own approaches. Michael Tanner, director of the Cato Project on Social Security Choice will be a panelist.

The discussion will take place Wednesday, August 4 at 10:00am. For more information on this event, or to register, click [here](#).

Edited by Brooke Oberwetter, boberwetter@cato.org. To subscribe or unsubscribe to *Social Security This Week*, please contact Feliz Ventura at (202) 789-5202 or fventura@cato.org.