



Social Security Choice

SOCIAL SECURITY THIS WEEK

A WEEKLY NEWSLETTER ON SOCIAL SECURITY REFORM

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Bush, Kerry Spar over Social Security

Although it has been overshadowed by the war in Iraq, healthcare, and the controversy over President Bush's National Guard service, Social Security has begun showing up in the presidential campaign. During campaign appearances last week, President Bush and Senator Kerry sparred over the president's proposal to allow younger workers to privately invest a portion of their Social Security taxes.

At a campaign stop in Cincinnati, Senator Kerry implied that the current deficit problem, fueled by the war in Iraq, is what threatens Social Security. According to the *Chicago Tribune*, Kerry told the audience, "They're raiding the Social Security trust fund in order to pay for their mistakes in Iraq." The Kerry campaign also unveiled a new ad this week with the same implication: that the war in Iraq is what is causing the squeeze on Social Security. Kerry spokesman Phil Singer later slammed Bush's Social Security proposal, saying it would reduce benefits and increase the federal budget deficit, according to *USA Today*. Singer referred to the president's plan as a "warmed over" version of his Social Security privatization plan from 2000.

President Bush, responding to the attacks, reiterated his belief that privatization could help solve the system's financial woes and ensure retirement prosperity. In a speech in Colmar, PA, the president criticized Kerry's economic record, noting that the senator has voted for Social Security tax increases numerous times. Bush responded more forcefully this week and took a swipe at the Kerry campaign rhetoric on Social Security in the process, calling their scare tactics "the most tired and pathetic way to campaign for the presidency," according to *USA Today*.

Though the Democratic nominee never seems to tire of attacking any kind of reform proposal that involves private accounts, several newspapers have noted this week that John Kerry has yet to outline exactly what he would do about the fiscal problems facing Social Security were he to be elected.

News Media Continue to Misrepresent the Costs of Reform

Reports are circulating that President Bush's Social Security reform plan will cost as much as \$2 trillion. [Michael Tanner](#), director of the Cato Institute's [Project on Social Security Choice](#), made the following comments on the true costs of Social Security reform:

“To say that President Bush's proposal for individual accounts in Social Security reform would cost \$2 trillion is to seriously misunderstand the word ‘cost.’ Social Security currently faces unfunded liabilities of more than \$26 trillion (nearly \$12 trillion in present-value terms). Just because those costs are not carried on the government balance sheet does not make them any less real. The Bush proposal would actually reduce those costs. While it is true that short-term spending would increase, that should not be considered a new cost any more than it should be considered an additional cost if you pay off your credit card debt today.”

For more information on reform costs, see “[‘Shooting from the Hip’ on Social Security Reform](#),” by Cato Senior Fellow [Jagadeesh Gokhale](#).

Ed Crane: Private Accounts Can Define Bush's Second-Term Agenda

In an op-ed released nationally this week, Cato president [Edward H. Crane](#) analyzes the urgent need for Social Security reform and makes a compelling case for converting Social Security into a system of personal accounts. Crane warns that merely seeking solvency shouldn't be the goal: rather, policymakers have a unique opportunity to fix many of the system's inherent flaws, such as its low rate of return and the inequalities it creates. The text of Crane's op-ed follows.

“In his acceptance speech to the Republican National Convention, President Bush forcefully renewed his call for fundamental Social Security reform. In doing so, he once again endorsed proposals to allow younger workers to privately invest at least part of their Social Security taxes through individual accounts. It is a bold stand—the proverbial ‘big idea; that can help define a campaign or a second-term agenda.

“And it is a stand that draws a bright line contrast between himself and John Kerry, who says that he believes Social Security needs nothing more than a ‘tweak,’ and ‘little jots and jags here and there.’ Kerry has yet to tell us what those ‘jots and jags’ are, but he has made it clear that he opposes any proposal to allow individual investment accounts.

“In taking on ‘the third rail of American politics,’ in Tip O'Neill's immortal phrase, President Bush is actually taking less of a political risk than commonly believed. Public opinion polls consistently show that voters across the political spectrum and in virtually every demographic, understand the need for Social Security reform, and support private investment accounts. Still, the president can expect a torrent of criticism from Senator Kerry and the ‘do nothing’ seniors lobbies, as well as resistance from the timid congressional leadership of his own party.

“Whether the president can use the issue successfully, then, depends on how he presents it to the American public. Therefore, as the campaign progresses this fall, here

are a few things that President Bush, Senator Kerry, and American voters should keep in mind.

Reform Can't Wait

“In less than 15 years, Social Security will begin running a deficit, spending more on benefits than it will take in through taxes. The Social Security Trust Fund has no real assets, a fact that President Clinton’s 2000 Economic Report of the President makes explicit. Overall, Social Security faces unfunded liabilities of more than \$11.9 trillion in present value terms, \$26 trillion in constant 2004 dollars. That will require much more than a ‘tweak’ to fix. And, the longer we wait to fix it, the worse the problem becomes. In fact, every two-year election cycle that we wait costs an additional \$320 billion.

“Moreover, Social Security is not just a long-term fiscal problem. Most American workers pay more in Social security taxes than they do in federal income taxes. That is money that is coming out of their next paycheck and sent off to Washington where it is not set aside in a personal account, but spent immediately. These workers need action today, not in 2018, or whenever the Washington politicians can work up the courage to act.

Solvency Is Not Enough

“The goal of Social Security reform should be to provide workers with the best possible retirement option, not simply to find ways to preserve the current Social Security system. After all, if solvency were the only goal, that could be accomplished with tax increases or benefit cuts, no matter how bad a deal that provided younger workers. A successful Social Security reform will of course result in a solvent system, not just in the short run, but sustainable over time as well. But it will also improve Social Security’s rate of return, provide better retirement benefits, and treat women, minorities, and low-income workers more fairly.

Size Matters

“Many proposals for Social Security reform would allow workers to invest only a small portion of their payroll taxes, perhaps one or two percent, and continue to rely on the existing Social Security system for the majority of their retirement benefits. This is a mistake, in terms of both substance and politics.

“The underlying economic premise of individual accounts is to take advantage of the higher returns available from private investment, what Einstein called ‘the most powerful force in the universe’—compound interest. Small accounts fail to take full advantage of the compounding dynamic. Moreover, small account proposals will not allow low- and middle-income workers to accumulate meaningful real wealth or achieve other objectives of reform.

“Individual accounts should be as large as feasible, ideally at least half of payroll taxes. There are several proposals in Congress now, including one by Rep. Sam Johnson

(R-Tex.), based on work by the Cato Institute, that show how this can be done in a fiscally responsible way.

There Is No Free Lunch

“Speaking of fiscal responsibility: Individual accounts will create a better, fairer, and more secure retirement system. But they cannot create miracles. They will provide higher retirement benefits than Social Security can pay. But they will not make everyone into millionaires. They will help solve Social Security’s financial crisis and save taxpayers trillions of dollars over the long run. But there is no free lunch. There are short-term costs that will require tough choices by the president and Congress. President Bush should not pretend otherwise. One possibility, which would actually be smart politics for the GOP, would be to end corporate welfare, a move that would cover a significant portion of the transition costs.

“On the other hand, it is also important to remember that the financing of the transition is a one-time event that actually serves to reduce the government’s future liabilities. The transition moves the government’s need for additional revenue forward in time but—depending on the transition’s ultimate design—it would not increase the amount of spending necessary. In effect, it is a case of ‘pay a little now or pay a lot later.’

Ownership Is the Key

“The central organizing theme of the president’s acceptance address was, ‘The Ownership Society,’ dealing with health care, retirement, home ownership, and Social Security. Ownership is particularly critical in the debate over Social Security. Most Americans are not aware that in 1960, in *Flemming v. Nestor*, the Supreme Court ruled that we have no property right in our payroll tax. Social Security was judged a social program of Congress and what you get back at retirement is, under the current system, entirely up to 535 politicians. That makes Social Security without reform very difficult to defend. As the architect of Chile’s hugely successful Social Security reform, José Piñera, puts it, ‘We all know the Social Security system is broke, but the fiscal problems are small compared to the culture of dependency the system fosters. There is no human dream stronger than the dream of having something to call your own.’

“In 2000, George W. Bush became the first major party presidential candidate since Barry Goldwater to campaign in favor of Social Security reform based on private accounts, and he won. In the 2002 congressional elections, every race where Social Security was a major issue, pro-reform candidates won. The American people are clearly ready for a candidate who will speak to them openly and honestly about the issue. George W. Bush now has the chance to become that candidate.”

Social Security Warrants Close Inspection of Candidates by Voters

Philip Fiorini, personal finance columnist for the Lafayette, IN *Journal and Courier*, [tells his readers](#) that there are striking differences between the presidential

candidates when it comes to Social Security reform and that the differences warrant close inspection. Fiorini suggests that it comes down to whether you look at the system as a retirement savings plan, as most Americans have come to see it, or an insurance system. An excerpt of Fiorini's column follows.

"Heading into another presidential election, there are clear differences in how George W. Bush and John Kerry plan to deal with the ills facing the nation's Social Security system, which some say is on track to go broke as early as 2042.

"Social Security was created in 1935 as a financial safety net that this year will provide about \$492 billion in benefits to 47 million Americans. But the math is clearly not in the system's favor.

"Initially, about 40 workers paid Social Security taxes for every one retiree receiving benefits. Today, because of America's aging population, that ratio is down to three workers per retiree. And at the current rate, Social Security would begin paying out more in benefits than it collects in taxes by 2019. And according to some estimates, it would be insolvent by 2042.

"In an effort to counter that, President Bush has remained a strong supporter of privatizing the Social Security program, saying workers would be able to invest some of their own contributions to the plan.

"We will always keep the promise of Social Security for our older workers,' Bush said during his nomination acceptance speech at the Republican National Convention.

"We must strengthen Social Security by allowing younger workers to save some of their taxes in a personal account—a nest egg you can call your own, and government can never take away. In all these proposals,' he added, 'we seek to provide ... more freedom and more control over your own life.'

"But Kerry has insisted that the best way to ensure Social Security's solvency is through federal policies that help grow the economy and boost wages, letting workers contribute more to the program.

"I guarantee you, the first best thing to do to protect Social Security is to put America back to work in jobs that pay more,' Kerry, the Democratic presidential challenger, said during a recent stop in Washington state.

"Between Kerry and Bush is Federal Reserve Board chairman Alan Greenspan, who has stressed the need to reform Social Security while at the same time calling for raising the eligibility age for full benefits, which is already set to gradually rise to 67 by 2027.

"Greenspan also has galvanized proponents of a measure to privatize at least a part of the Social Security system, permitting workers to invest some of the money paid into the retirement system in private accounts such as stocks or bonds.

“That’s similar to the ‘6.2 Percent Solution’ first proposed in 1980 by the Cato Institute. Through that plan, individuals would be allowed to divert half of their payroll tax—6.2 percent—to individually owned, privately invested accounts.

“Those who chose to do so would agree to forgo all future accrual of retirement benefits under the traditional Social Security system. The remaining 6.2 percent of payroll taxes would be used to pay transition costs and to fund disability and survivors’ benefits.

“Lafayette businessman John Becker knows why the Social Security issue isn’t rising to the top of the presidential debate: ‘People don’t want to talk about it ... It was put together as a Ponzi scheme to begin with.’

“Still, Becker, a 61-year-old health care compliance specialist, is convinced that something will be done to fix Social Security, with a combination of privatizing the system and raising the retirement age even higher than 67. Moreover, he said, the longer the U.S. government insists that Social Security will always be there for all retirees, the bigger the mistake will be someday for those who haven’t saved for retirement.

“‘It was originally sold as an insurance policy,’ he says of Social Security, ‘not as a retirement policy.’

“But if Social Security is a big issue for you, you might try to look a little closer at where Bush and Kerry stand.”

Augusta Free Press on the Cato Plan

Writing in the *Augusta Free Press*, columnist Stephen Winslow [discusses the issues](#) surrounding the Social Security debate. Winslow features the Cato Institute position on Social Security, writing:

“President Bush has consistently proposed diverting some Social Security contributions into personal savings accounts that could be invested just like a 401(k). Though more people are beginning to warm up to the idea, including Rep. H. Ford Jr., D-Tenn., not everyone is embracing the plan.

“So how will [John Kerry] fund Social Security? Actually, it is very clear where the money will come from. Michael Tanner of the Cato Institute says, ‘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 Sen. Kerry rules out private investment or benefit cuts, he could legitimately be accused of implicitly endorsing tax increases.’

“And mighty big tax increases they would have to be. Cato reports that a 50 percent increase in the payroll tax, or the equivalent, would be necessary. They state that this would be a tax hike far higher than what Kerry would ‘save’ by rolling back parts of President Bush’s tax cuts—even if he hadn’t already promised to use those savings to fund other government spending.

“Social Security will start running a deficit soon because it will begin spending more money on benefits than it takes in through taxes. According to the last report of Social Security’s trustees, by 2018, the so-called Social Security Trust Fund, which is supposed to help pay benefits until 2042, in reality contains only government bonds, essentially an IOU.

“Cato reports that ‘in 2018, the first year that Social Security faces a shortfall, the cash deficit will exceed \$17 billion.’ That’s almost as much as Kerry has proposed in increased spending on Pell Grants. They state that ‘by 2022, the annual Social Security deficit will have grown to roughly \$100 billion,’ which is as much as Kerry would spend for a proposed energy trust, increased veterans benefits, fully funding Head Start and increased spending on homeland security.

“‘By 2027, with the annual deficit approaching \$200 billion, you can add in the his proposed increases in aid to state and local governments, his national service plan, and science and technology research.’ And big government is off and running...

An Alternative Plan

“The Cato Institute has a plan to address the growing crisis of Social Security funding. The Cato Project on Social Security Choice has developed a proposal to give workers ownership of and control over their retirement funds. The plan is a comprehensive approach to relieving pressure on the federal government and the economy. As they say, the details are where it’s at ...

“Under the CATO proposal:

- Individuals would be allowed to divert their half (6.2 percentage points) of the payroll tax to individually owned, privately invested accounts. Those who chose to do so would agree to forgo all future accrual of retirement benefits under the traditional Social Security system.
- The remaining 6.2 percentage points of payroll taxes would be used to pay transition costs and to fund disability and survivors' benefits.
- Workers who chose the individual account option would receive a "recognition bond" based on the accrued value of their lifetime-to-date benefits. Those bonds, redeemable at the worker's retirement, would be fully tradable in secondary markets.
- Those who wished to remain in the traditional Social Security system would be free to do so, accepting a level of benefits payable with the current level of revenue.

“Tanner states, ‘We expect this plan to restore Social Security to long-term and sustainable solvency and to do so at a cost that is less than the cost of simply propping up the existing program. And it would do far more than that.’

“Tanner believes that younger workers who chose the individual account option would receive benefits substantially higher than those that could be paid under

traditional Social Security. At the same time, the plan would treat women and minorities more fairly and allow low-income workers to accumulate real wealth.

“Most important, this proposal would reduce Americans’ reliance on government and give individuals greater ownership of wealth, as well as responsibility for and control over their own lives. It would be a profound and significant increase in individual liberty,” said Tanner.”

Publications

The Social Security Administration has released the latest issue of its newsletter “[International Update](#).” The publication for August looks at the most recent international developments concerning pension reform. This month’s issue discusses movements toward reform in Austria, Italy, Colombia, Ecuador, and Nicaragua.

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.