

Social Security Choice

SOCIAL SECURITY THIS WEEK

A WEEKLY NEWSLETTER ON SOCIAL SECURITY REFORM

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White House: Bush Sees Reelection as a Social Security Mandate

According to a recent report in the *White House Bulletin*, President Bush may be gearing up for a swift and decisive push for Social Security reform should he be re-elected. Though concerns remain that Congress might not be ready to take up the issue due to political considerations, the *Bulletin* implies that the administration would push ahead anyway. The pertinent text from the bulletin follows.

“White House officials say privately that President Bush plans a big and immediate push for Social Security reform if he wins re-election on November 2. He tells aides he hasn’t lost interest in partially privatizing the system by allowing people to invest their retirement money their own way. Bush wants to ratchet up the issue no matter how difficult it might be to win passage in Congress, and White House insiders tell U.S. News and the Bulletin that he is now prepared to claim a mandate for the idea if he wins.”

Kerry’s Social Security Claims Criticized

Late last week, several sources disputed John Kerry’s dubious claims that privatization of Social Security would create a “\$940 billion windfall” to the financial services industry while at the same time cutting benefits for retirees by some 45%.

The National Center for Policy Analysis released a fact sheet demonstrating that the study by University of Chicago professor Austan Goolsbee cited by John Kerry vastly overestimated the administrative fees involved in a system of private retirement accounts. According to the NCPA fact sheet:

It is reasonable to expect that firms managing personal retirement account assets would receive compensation for their services; after all, there would be some 148 million accounts to manage. But Goolsbee’s assumptions seem to be based on 401(k) and mutual fund plans with all the bells and whistles. By limiting options and structuring the accounts carefully, administrative fees could be reduced.

- The General Accounting Office says, “estimates for a centralized system with limited investment choices and customer service are as low as **0.1 percent of assets** per year.” [See the [full report](#)]

- Bill Shipman, formerly a principal of State Street Global Advisors, suggests that fees could be as low as **0.18 percent to 0.34 percent of assets** over the first five years, depending on assumptions made. [See the [full report](#)]
- Vanguard's S&P 500 Index Fund has an expense ratio of only **0.18 percent**. [[See here](#)]

Meanwhile, *National Review's* [Ramesh Ponnuru took issue](#) with Kerry's claims that the Goolsbee study found that benefits would be drastically cut under a privatization plan. Goolsbee, it turns out, was also surprised that the Kerry campaign cited the study as evidence that privatization would lead to benefit cuts. In the following commentary, Ponnuru clears up this and other faulty assumptions made by the Kerry campaign.

“On Wednesday, the Kerry campaign issued a false press release. It claimed that a study by Austan Goolsbee had proven that under the president's Social Security plan, ‘the 45 million Americans who count on Social Security will see up to a 45 percent cut in their benefits, while Bush's biggest backers—the financial services industry—will reap billions as part of the largest windfall in Social Security history.’ Goolsbee's study said nothing about benefit levels, let alone for today's retirees, and after [he told me so](#), the Kerry campaign revised its [press release](#). Good for it.

“The campaign has backed off its claim that Goolsbee's study tells us anything about benefit levels under a Bush-style reform. They have also gotten rid of all the language that claims that today's retirees would see their benefits cut—since there's no way they can make that claim honestly. Instead, they are using somewhat ambiguous language that implies the claim. When the campaign says that he will protect seniors from benefit cuts, it's up to the reader to understand that it is referring to the seniors of future decades, not to today's seniors.

“What are the Kerry campaign's assumptions? The campaign analyzes one of the three plans that the president's Social Security commission put forward and calls it the president's plan. It relies on a Congressional Budget Office study that found that this plan would involve benefit cuts if individual investors got no higher rate of return than a Treasury bond. That's sort of a no-brainer. *If you're trying to eliminate the entire long-term deficit of Social Security and not to raise taxes and there are no investment gains or tax increases, then benefits are of course going to go down.* But this is not the only possible outcome, and the CBO does not say that it will come to pass. The Social Security Administration and the president's commission on Social Security have concluded that under more optimistic, but plausible, assumptions, it is possible to fix the program's deficit while also leaving future retirees better off.

“Kerry cites Goolsbee for the proposition that individual accounts would provide a \$940 billion windfall to Wall Street firms. This result actually does appear in Goolsbee's paper. It is the result of assumptions about administrative costs. Goolsbee assumes that those costs will be comparable to the costs in private-sector defined-contribution plans, and that the proceeds would go to Wall Street firms.

“Douglas Holtz-Eakin, the director of the CBO, notes that his agency uses the government’s Thrift Savings Plan for federal workers as its model. A Social Security reform plan modeled on the TSP, he says, would likely yield lower administrative fees—and could result in most of those fees going to a government agency rather than to Wall Street. Even if firms received \$940 billion in revenue, the CBO director adds, it would be necessary to look at the costs those firms would incur before concluding that they would receive a windfall profit and that nobody else would benefit from that cashflow.

“Finally, the Kerry campaign assumes that the president’s plan would tax away (‘claw back’) 80 percent of the individual accounts at retirement. This is a mistake. The actual plan that the commission outlined—it was one of three plans, remember—allows people to put away money in an individual account. The more they put in, the less the government will pledge to give them to supplement their accounts when they retire. That’s the trade-off this plan offers to workers: You get to invest your Social Security taxes, in return for increasing your dependence on your investments. That’s the way the program’s shortfall can be reduced even while workers get a chance at higher returns. But the gains that people make in their accounts would not be taxed: They would be 100 percent the property of the account owners. The supplemental benefits from the government would not go down because someone’s investments had done well. None of the commission’s models involve that kind of clawback.

“So: To get bad results for Social Security reform, Kerry has had to make a series of unlikely assumptions about what kind of reform plan would be offered—some of them assumptions that can draw no support from anything that has taken place in the world outside of his press releases.”

Joseph C. Phillips: Reform Can Empower Black Communities

In a segment on NPR’s *Travis Smiley Show*, commentator and television personality Joseph C. Phillips presented his views on Social Security privatization and the black community. In his commentary, Phillips links economic empowerment for African Americans with Social Security privatization. He also points out that Social Security as it currently exists drains the black community of its hard-earned money and redistributes it to the wealthy, who tend to live longer and therefore collect more benefits. Phillips’s complete comments from the broadcast follow.

“For more years than I can count, I have heard voices in the black community cry out for economic empowerment. They’ve stressed the need for transferring an economic legacy from one generation to the next in order to build real wealth in the black community. Well, there is no better opportunity to put the rubber to the road, so to speak, than ownership of our Social Security benefits in the form of private retirement accounts.

“Our Social Security system was originally conceived as a progressive insurance program whereby today’s workers pay for the retirement of the previous generation of workers. Well, quiet as it’s kept, most of us were never meant to recoup our investment. When Social Security became law, the average life span for a man was 61. The age at

which one could begin receiving benefits was 65. Almost half of the eligible recipients died before they were able to collect.

“Today, of course, all that has changed dramatically. With advances in health care and changes in lifestyle, men are living well into their 70s and women almost to 80. The result of this change in the mortality rate is that huge amounts of money are now being transferred away from the people it was intended to help. The wealthy live longer than the poor, married couples live longer than singles, and whites live longer than blacks. And this last fact means Social Security now represents perhaps the largest transfer of wealth out of the black community into other communities.

“My father offers the perfect illustration and is precisely why younger black workers should be paying close attention to the current discussion of Social Security reform. After paying into the system for 45 years, my father died after drawing on his investment for only one year. Following his death, rather than go to his heirs as a legacy, the money he worked so hard for was given to another family.

“Think for a moment about ownership of an investment making 7 percent interest compounded over 45 years. Think now of what that kind of money could mean for a family, what that much money could mean for a community, how many black families would become new homeowners, how many college educations could be funded, how many small businesses started. Now think about which party it is that is saying to this community, ‘We want to give the reins of power back to you. We want you to have the opportunity to build wealth and participate fully in the American dream as partners instead of dependents of the federal government.’

“Well, detractors are quick to point to the high cost of transitioning from the current system of political entitlement to one of ownership and investment. Ironically, however, according to the Alliance for Retirement Prosperity, the \$1.6 trillion debt that would be incurred to fund the transition is roughly equal to the deficit the current system will have amassed by 2028. According to the chief actuary of Social Security, the difference is that personal accounts described in the current plan before the House will completely eliminate the Social Security deficit over time, without any benefit cuts or tax increases and produce higher benefits than those Social Security promises.

“Social Security reform has the potential to transform our community. True empowerment will move us from a community of renters to one of owners, from a consumer base to an investor class, from dependency to autonomy. Is there a cost to reform? Certainly. But the questions for our community are: What is the cost we’ve already paid, and what is the greater cost of inaction?”

Thomas Sowell: Privatization Is Less Risky than the Current System

Commentator Thomas Sowell delivered a pair of commentaries this week on *Townhall.com*, asserting in the first that politicians who call privatization “risky” have it backwards; Social Security as it currently exists is the true “risky scheme,” not privatization, he writes. He concludes that “Nothing is more risky than depending on politicians.” Excerpts from his first commentary follow.

“Would you sign a contract that enabled the other party to change the terms of that contract at will, while you could neither stop him nor make any changes of your own? Probably not. Yet that is exactly what happens when you pay money into Social Security.

“No matter what you were promised or at what age you were supposed to get it, the government can always pass a new law that changes all of that. But you still have to pay into the system.

“A private annuity plan run by an insurance company is legally required to pay you what was promised, when it was promised, and to maintain assets sufficient to redeem its promises.

“One of the few issues on which Senator John Kerry has taken a stand and not changed it (yet) is Social Security. He has said: ‘I will not privatize Social Security.’

“This has long been the position of liberal Democrats, and John Kerry’s voting record in the Senate makes him one of the very few Senators more liberal than Ted Kennedy. That is the ranking given by Americans for Democratic Action, a leading liberal organization that ought to know.

“Why are liberals against letting people put part of their Social Security payments into private investments?

“Risk is one of their arguments. Al Gore incessantly repeated the phrase ‘a risky scheme’ during the 2000 election campaign and risk still seems to be the big objection to letting people put their own money where they want.

“Some liberals may actually believe that politicians know what is best for you better than you know yourself. That is, after all, the philosophy behind many other government programs.

“Another reason for liberal opposition to private investment of Social Security payments is that it deprives them of control of billions of dollars that they have been spending from the Social Security trust fund for years. They can buy a lot of votes with all sorts of giveaway programs, financed by money taken from Social Security.

“As for the risk of making private investments, that might be a real concern if people were putting their money into commodity speculation or other volatile markets. Most people have better sense and privatization could limit where Social Security premiums could be invested.

“Although the stock market bounces up and down from day to day, people are not investing today in order to retire next week. They begin paying Social Security premiums when they first get a job and they retire decades later.

“Stocks are far less risky in the long run than they are in the short run because the ups and downs balance out over a long period of time. It is virtually impossible to find any 40-year period in which the stock market has not paid a higher rate of return on your money than you get from Social Security....

“Social Security has been run like a pyramid scheme, where the first people to pay in get money back from the second wave of people who pay in, and the second wave get money back from the third wave, etc. This is so risky that pyramid schemes are illegal—except when the government does it.

In his second commentary, Sowell discusses the adverse effects of Social Security on workers. Specifically, he argues, Social Security’s unfunded liabilities have given the government *carte blanche* to undermine employment contracts by banning mandatory retirement ages. This not only hurts employers and older employees who may have contracted specific retirement ages, but it also hurts younger workers who find themselves unable to move up because would-be retirees decided to stay on the job longer than anticipated. An excerpt from Sowell’s second commentary follows:

“ That is where so-called ‘mandatory retirement’ comes in. That concept is as fraudulent as calling Social Security ‘insurance’ when it has in fact always been a pyramid scheme, where each generation depends on the next generation to pay its pensions.

“There has never been any such thing as mandatory retirement. By contract or custom, employers have had a general practice of no longer employing people after they reached a certain age. But there has been no requirement that those people retire. Many—if not most—have in fact continued working elsewhere, often while drawing a pension.

“By passing laws forbidding ‘mandatory retirement,’ the government reduced the number of older people who would otherwise have retired and begun drawing Social Security pensions. This self-serving transfer of billions of dollars in financial liabilities from the government to private employers was thus presented as a virtuous rescue of older workers from unfair discrimination.

“Never mind that the Constitution forbids the government from changing the terms of private contracts. Never mind that younger workers find their upward path blocked by older workers whom the employer cannot get rid of without legal hassles.

“All of this is washed down with lofty rhetoric about how age need not mean a decline in efficiency, about how our senior citizens still have much to contribute, about how older Americans are ‘breaking the silver ceiling,’ in the words of Senator John Breaux at recent Senate hearings.

“In other words, the assumption is that individual employers looking directly at individual workers, whose work they are already familiar with, are not smart enough to make as good a judgment as distant politicians talking in generalities.”

Cato Scholar Suggests a Social Security Wager

Cato adjunct scholar Michael New writes in a [Cato Daily Commentary](#) that if supporters of PRAs continue to dodge the issue, meaningful reform will never happen. To avoid losing ground in the debate and to generate new support for private accounts,

New proposes a novel experiment. Inviting Kerry to put his money where his mouth is, he suggests that Bush should challenge Kerry to prove that PRAs are not better for workers and retirees than the current system. New's commentary follows.

"In an effort to court senior citizens in the final few weeks before the 2004 election, opponents of Social Security reform have begun their usual scare tactics. Last week (9/21), Democratic presidential nominee John Kerry charged that President Bush's plan to allow younger workers to establish private accounts would generate a \$940 billion windfall to the financial services industry while cutting benefits for senior citizens. The *New York Times* editorial board got in on the act as well, saying that the private accounts option would result in reduced benefits and less reliable incomes for retirees.

"President Bush has done a fair amount to advance the cause of Social Security privatization. To the surprise of many, he first raised the issue during the 2000 presidential primaries and he advocated private accounts during his acceptance speech at the 2000 Republican convention. Upon taking office, he created a bipartisan commission to explore Social Security reform options, including private accounts. And, at last summer's 2004 Republican convention, he again pushed the idea of private accounts as part of his 'Ownership Society' initiative.

"Unfortunately, if history serves as any indication, Bush will probably choose not to engage Kerry on the issue in the final, heated weeks of this year's campaign. In general, when reform supporters are confronted with such scare tactics, they back down and pledge to uphold the current system. Such a response may be effective at deflecting criticism, but it does considerable damage to Social Security's long-term prospects.

"Indeed, Social Security is going to require some sort of major overhaul in the near future simply because it is not financially viable over the long term. But before any sort of meaningful reform can occur, people need to hear various ideas debated for a number of years. If reform supporters insist on dodging the issue, those important discussions will never take place.

"Clearly, supporters of private accounts need another strategy. One way to do this is to raise the stakes in the debate, both figuratively and literally. This could be done through a wager. For instance, President Bush could make the following proposal to Sen. Kerry:

"Take two workers, each earning an identical income. One will be allowed to invest 2 percent of his income in a private Social Security account. The other will have to place the same amount of money into the current government-run system. After a specified amount of time, analysts will calculate the amount of return each worker would have received on his investment. If the worker who kept his money in the traditional Social Security program would come out ahead, Bush will pay Kerry the difference. Likewise, if the reverse happens, Kerry would pay Bush the difference.

"Such a wager could change the dynamics of the debate on Social Security reform. Suppose that Kerry refused the wager. He would then rightly face criticism for refusing to believe his own sound bites and having little faith in his own policy proposals.

However, if Kerry accepted the wager, the private accounts would surely come out ahead in the long run. That would visibly demonstrate the benefits of private accounts in a way that is easy to understand and would advance the prospects for reform.

“Such a wager would dramatically advance the long term prospects of reform. For once, it would put reform proponents on the offensive on the issue. It also would facilitate debate and discussion as people could see the tangible benefits of private Social Security accounts. Finally, at least one prominent opponent of reform would be left with fewer resources to make his misleading accusations around election time.”

Boston Herald Slams Kerry's Social Security Stance

An editorial in the [*Boston Herald*](#) this week slams John Kerry for what seems like indecisiveness on Social Security. His pandering to Florida seniors implied his steadfast opposition to raising the retirement age and cutting benefits, yet he had previously called for bold action on reform, including means-testing and raising the retirement age. The editorial concludes that Senator Kerry has been elusive on the matter because he is most likely planning on taxing his way out of the system's financial problems should he be elected president. The full text of the editorial follows.

“OK, so we know what John Kerry says he won't do about Social Security if he's elected. When will he fill voters in on what he would do?

“Alas, the deep-thinking Democratic presidential nominee has ‘evolved’ on yet another issue. Having promised in 1996 to tackle ‘unpopular’ Social Security solutions, this week he was reduced to pandering:

“I will never privatize Social Security! Period. And I will not cut Social Security benefits.’

“His audience loved it. Heck, talking about protecting Social Security in West Palm Beach, Fla., is about as courageous as extolling the virtues of ethanol made from corn in Iowa.

“We can't even count on Kerry's allies on *The New York Times* editorial page to explain the elusive Kerry plan. Instead, it spent reams of newsprint yesterday predicting President Bush's plan to let workers invest some of their retirement savings will knock the Earth off its axis. A future editorial, it said, will compare the two candidates' plans but we presume that will have to wait until Kerry actually has one.

“For now, voters will have to resort to looking for clues to Kerry's position in his voting record and past statements on the issue. Don't you hate when that happens?

“In 1996, Kerry boldly proclaimed to a *Boston Globe* reporter that it was time Congress debated raising the retirement age and means-testing benefits.

“I know it's all going to be unpopular,’ he said at the time. ‘But this program has serious problems, and we have a generational responsibility to fix them.’

“Oh yes, and it was ‘wacky,’ according to the senator then, that Social Security taxes didn't apply to income over \$62,700.

“Now candidate Kerry says he’ll just let a rising economy lift the Social Security boat.

“Ah, there’s a plan to fill a deficit which Social Security trustees predict will open in 2018 to the tune of \$17 billion, with the system careening toward bankruptcy by 2042. Why didn’t we think of that!

“As Michael Tanner, a respected Cato Institute Social Security expert has said, since Kerry has ruled out cutting or privatizing benefits, the only real option left is raising payroll taxes.

“At least on the tax front, Kerry has been uncharacteristically consistent, voting to increase taxes on Social Security benefits in the 1993 Clinton tax package and voting three times against repealing that increase (including as recently as March 2003).

“Shhh, just don’t tell the West Palm Beach set.”

Alan Reynolds Paints a Bleak Portrait of the Kerry Plan

Writing over the weekend in the *Washington Times*, Cato senior fellow Alan Reynolds unlocks the meaning behind the Kerry rhetoric on Social Security, suggesting that what some call a “do-nothing” plan for Social Security would actually be a steep tax hike for many Americans. More troublesome, argues Reynolds, would be the unintended economic consequences of such a measure. An excerpt of Reynold’s column follows.

“Critics quickly called [Kerry’s promises] a ‘do nothing’ plan, but that just showed they couldn’t translate political doubletalk. While Mr. Kerry may not want to cut benefits for those who ‘rely on’ or ‘need’ Social Security, he has flirted with cutting benefits for everyone else—namely, *prudent* seniors who plan to rely primarily on other pensions, individual retirement accounts, 401(k) plans and personal savings, as well as *industrious* seniors who keep working and paying the Social Security tax.

“And when Mr. Kerry and Edwards say they ‘will not raise Social Security taxes,’ they mean they won’t raise them on those with incomes below \$88,000. They would, however, raise the cap on the amount of income subject to the 12.4 percent Social Security tax by 36 percent—from \$88,000 to \$120,000. For those with incomes in that range, marginal tax rates would jump by 10 percentage points (less than 12.4 percent because the employer’s half is tax deductible).

“Many taxpayers now in a 28 percent tax bracket would suddenly face a marginal tax of 38 percent on any extra earnings from overtime, raises or promotions. Many in the 25 percent bracket would likewise face a marginal tax of 35 percent.

“Although it can be argued the Social Security tax is partly a prepayment for an annuity, that would not be true in this case. The victims of this cash grab would be expected to pay up to \$4,000 more in Social Security tax, year after year, without a dime in increased benefits. This something-for-nothing tax offer would create an unusually potent disincentive. It would make more attractive income in forms not so easily confiscated by the IRS, such as perks, retirement benefits and leisure.

“Martin Feldstein, president of the National Bureau of Economic Research, estimates this would cut income reported by about 7 percent, due to reduced effort and increased tax avoidance. Mr. Feldstein estimated the tax would therefore raise only about \$5 billion a year. But the total burden on the private economy would be much larger.

“On the benefits side, Mr. Feldstein noted Mr. Kerry said he would consider ‘making sure that high-income beneficiaries don’t get more out than they pay in.’ Such means-testing involves cutting Social Security benefits 80 percent for those who paid the most in Social Security taxes, by Mr. Feldstein’s calculations. Moreover, by emphasizing that ‘current law revenues would be sufficient to pay 73 percent of scheduled benefits after trust-fund exhaustion in 2042,’ the Kerry campaign is actually conceding total benefits may be cut 27 percent. Reneging on Social Security’s promises to high-income seniors would make an imperceptible contribution to such a huge cut—so most benefits would have to be cut by 20 percent or so.

“President Clinton already set a dangerous precedent for means-testing Social Security benefits in 1993 by taxing 85 percent of Social Security benefits for seniors whose other income (from pensions, saving and work) exceeds the ‘high income’ of \$44,000 per couple. Those with lower retirement incomes pay tax on none of their benefits, or on only half. The 1993 surtax on Social Security benefits was just a devious way of cutting benefits substantially, but only for those who were prudent (and therefore saved for retirement) or industrious (and therefore kept working after age 62–65).

“President Clinton set a far more dangerous precedent in 1993 when it comes to the tax side of the Kerry-Edwards agenda. The cap on income subject to the 2.9 percent Medicare tax was not just raised by a large amount, as Mr. Kerry and Mr. Edwards propose for Social Security, but eliminated completely. The sky is now the limit when it comes to the taxes some must now pay for Medicare’s mediocre yet mandatory health insurance.

“It doesn’t take much imagination to view the Kerry-Edwards Social Security tax proposal as a Trojan Horse—a first step toward eliminating the income cap altogether, as the Clinton administration did with the Medicare tax. This has long been the dream of income-leveling Democrats such as Robert Kuttner and of socialist Michael Harrington, who promoted the idea in ‘Dissent’ in 1988.

“If Congress were ever so foolish as to eliminate any income ceiling on the Social Security tax, the United States would face the highest marginal tax rates in the civilized world. With the Kerry-Edwards income tax increase, stepping over this year’s \$178,650 income threshold on a joint return would cause a very sharp jump in the tax rate from 28 to 36 percent. Above \$319,101, the tax rate would be 39.6 percent.

“The top two marginal rates are higher than they look because itemized deductions begin to be phased out if income tops \$142,700 and personal exemptions are phased out above \$214,050. Add 2 or 3 percentage points to roughly account for that, and the top two tax rates would be about 38 percent and 42 percent.

“That doesn’t count state income taxes, highest where many high-income people live—7.7 percent in New York, 9.3 percent in California and 9.5 percent in D.C. Because state taxes are deductible, add another 5 percentage points for them. And add another 3

points for the Medicare tax. That puts the top Kerry-Edwards income tax rates at about 46 percent and 50 percent, respectively.

“Eliminating the cap on Social Security taxes, as was done with Medicare taxes, would add another 10 percentage points for everyone now in the 28–35 percent income tax brackets. The top two tax rates on labor income would then be about 56 percent and 60 percent. Even the most brutally overtaxed, stagnant European economies do not impose marginal tax rates that high. The United States would have a higher marginal tax rate than Germany (47 percent) and even Sweden (56 percent). Nearly all major countries still cap annual income subject to Social Security tax (such as 54,000 euros in Germany). And Social Security taxes are generally deductible in Europe and Japan, to avoid double taxation of labor.”

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