



Social Security Choice

SOCIAL SECURITY THIS WEEK

A WEEKLY NEWSLETTER ON SOCIAL SECURITY REFORM

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Gokhale to Join Cato Social Security Team

Jagadeesh Gokhale, one of the nation's leading economists and an expert on entitlement reform, has joined the Cato Institute as a senior fellow. Gokhale, former senior economic adviser to the Federal Reserve Bank of Cleveland, has been on leave from the Fed for the past year, serving as a visiting scholar with the American Enterprise Institute. Gokhale will work with Cato's Project on Social Security Choice, examining the problems of the current Social Security system and helping to design market-based alternatives.

Gokhale's is widely recognized as one of the nation's leading experts on U.S. fiscal policy and its intergenerational impact. His analysis of the sustainability of entitlement programs such as Social Security and Medicare was published in the Budget of the United States Government (1993, 1994, and 1995), and he has testified before the Senate Budget Committee on Social Security's treatment of postwar U.S. generations. In related work, Gokhale has studied how fiscal policy affects national saving and the accumulation and distribution of wealth. Gokhale has also constructed computer simulations to study the causes of wealth inequality in the United States with a special focus on the role of bequests in transmitting wealth inequality across successive generations.

Gokhale has been widely published in top academic journals such as the *Journal of Economic Perspectives*, *Quarterly Journal of Economics*, *Review of Economics and Statistics*, and the *Brookings Papers on Economic Activity*, as well as in several publications of the National Bureau of Economic Research and of the Federal Reserve Bank of Cleveland. His latest book, [*Fiscal and Generational Imbalances: New Budget Measures for New Budget Priorities*](#), coauthored with Kent Smetters, was released by AEI this past June. Gokhale is also the author of "[The Impact of Social Security Reform on Low-Income Workers](#)" and coauthor of "[Social Security Privatization: One Proposal](#)" (with David Altig), both Cato Institute Social Security Choice Papers.

Gokhale received his PhD in economics from Boston University.

"We are excited to have someone of Jagadeesh Gokhale's skill and reputation join our team," said Michael Tanner, director of the Cato project. "With the imperative of

Social Security reform moving ever closer, Jagadeesh's skill and enthusiasm will be invaluable."

Wall Street Journal: Viable Large Personal Accounts

Using the release of the Social Security Administration's actuarial [analysis](#) of [Peter Ferrara's](#) Social Security [reform proposal](#) as a springboard, the *Wall Street Journal* called for President Bush to run on the issue of individual retirement accounts—and according to the SSA, they don't have to be small accounts either. Excerpts of the article follow:

"As Peter Ferrara details [next], the big news is that a transition to even large personal Social Security investment accounts can be financed without cutting benefits or raising taxes. This is the conclusion of Steve Goss, the nonpartisan chief actuary of the Social Security Administration, and his professional career staff.

"Mr. Goss has run the numbers on Mr. Ferrara's proposal to let workers invest an average of 6.4 percentage points of the 12.4 percent payroll tax in such accounts, and more for lower-income workers. Under that proposal, Mr. Goss's analysis concludes, 'the Social Security program would be expected to be solvent and to meet its benefit obligations throughout the long-range period 2003 through 2077 and beyond.'

"Recall that Mr. Bush campaigned in 2000 for a voluntary private-investment option for younger workers. Social Security is now an inter-generational transfer program, in which younger workers finance (out of current wages via the payroll tax) the benefits of current retirees. The reform idea is to allow younger workers to invest some of their payroll taxes in stocks and bonds that would allow them to build a nest egg that finances their own future retiree benefits. The accounts would be their private property and thus not vulnerable to future political whim the way the current system is.

"The fiscal rub has always been how to pay for the transition from here to there—essentially, how to finance the unfunded Social Security liabilities associated with the looming Baby Boom retirements. Opponents of reform claim that steep benefit cuts or tax increases will be necessary—all of which they know (or hope) will be politically impossible.

"The importance of Mr. Goss's number-crunching is that he shows this transition can be financed without either of those reform-killing caveats. It also rebuts the current Beltway conventional wisdom that the chance to reform Social Security vanished along with federal budget surpluses. And it rebuts the view, held even by some reformers, that only a small, two-percentage-point allocation to personal accounts is politically and financially doable.

"Not that there is any free lunch. The transition would still have to be financed, and in the case of the Ferrara proposal Mr. Goss posits a combination of mild spending restraint on other federal programs (1 percent slower than baseline growth for eight years), more government borrowing for a time, and additional revenues that will come from higher corporate profits once the private investment from personal accounts begins to build. If spending restraint proves illusory, additional borrowing could make up the difference.

“The only issue is how to pay for these promised liabilities. Without raising taxes or cutting benefits, the government will have to borrow more to pay Baby Boomer benefits in any case. In a transition to personal investment accounts, that borrowing would be larger in earlier years but it would be smaller in the future as the accounts built up assets.

“The broader political and policy message here is that Mr. Bush and other reformers should think bigger. Intimidated by opponents, some reformers want to settle for smallish (two-percentage-point) accounts, but those would only lengthen the transition because assets would build so much more slowly. Mr. Bush’s 2001 Social Security Commission did a superb analysis of the current system’s future dilemmas, but it also posited overcautious solutions. The new Goss analysis shows the White House can afford to be bolder, and at a minimum needn’t box itself in by agreeing to any ‘2 percent-solution’ during the 2004 campaign.”

Ferrara Touts Reform Plan

According to a [memorandum](#) from the Social Security Administration, Peter Ferrara’s reform plan, if enacted, would bring the system to solvency and meet Social Security’s benefits obligations. Writing in the Wall Street Journal, Ferrara made the case for his plan:

“George W. Bush put the idea of a personal account option for Social Security on the national agenda ... Such reform would allow workers the freedom to choose to shift a portion of their Social Security payroll taxes into their own personal investment account, which would then finance a proportionate share of future Social Security retirement benefits.

“But up until now, establishment Washington has assumed that at most an option for only two percentage points of the 12.4 percent Social Security payroll tax would be feasible. The Social Security Administration (SSA), however, [released] an official score for a proposal for much larger personal accounts, averaging 6.4 percentage points. That score shows that such large personal accounts would achieve permanent solvency for Social Security, without benefit cuts or tax increases. Moreover, it shows that the transition financing burdens of such reform would be quite manageable.

“The proposal ... would allow workers to shift five percentage points of the payroll tax into their own personal account, but on the first \$10,000 of income that would be doubled to 10 percentage points. This makes the proposal quite progressive, with lower income workers able to devote a higher percentage of their Social Security taxes to the account.

“At standard, long-term, market-investment returns, these accounts would be large enough to pay workers substantially more than Social Security promises, but cannot pay. Indeed, the progressivity of the proposal mirrors the progressivity of Social Security, with workers at all income levels gaining about the same percentage over what Social Security promises, about two-thirds more.

“These investments would be made through a social structure where workers would choose from a broad range of investment funds managed by major firms, approved and regulated by the government.

“The SSA score, produced by Chief Actuary Stephen Goss and his staff, assumed the reform begins in 2005. With workers likely choosing the personal accounts overwhelmingly, over time the accounts would take over more and more of the benefit obligations of Social Security. By 2055, almost all of the program’s retirement benefits would be paid through the personal accounts, permanently eliminating all of the deficits of the current program just through the accounts alone.

“The score also shows that the transition deficit before that point, created by workers shifting so much of their payroll taxes to the accounts, would be covered entirely by four factors. One is the short-term Social Security surpluses through 2017. Second is the funds obtained by reducing the rate of growth of total federal spending by 1 percent per year for each of just eight years, through 2012. Third is the increased revenues that would result from increased savings and investment through the accounts.

The final factor would be to sell excess Social Security trust fund bonds to cover any remaining trust fund deficit in the early years ... The Social Security trust funds would never fall below \$1.38 trillion, enough to finance 145 percent of one year’s benefits. The SSA’s standard for solvency is 100 percent. With these transition financing sources, Social Security goes into permanent, growing surplus in 2029, with the trust funds eventually accumulating to an excessive \$6.3 trillion. Within the following 15 years, the surpluses would be sufficient to pay off the trust fund bonds sold in previous years.

“This solvency is achieved with no benefit cuts and no tax increases. Because of the much higher returns on real capital investment than on purely redistributive, pay-as-you-go Social Security, the personal accounts would also produce much higher benefits for future retirees than Social Security promises, let alone what it can pay.

“Such reform would also eliminate the unfunded liabilities of Social Security, currently about \$10.5 trillion, roughly three times as large as the currently reported national debt. The reform would consequently also produce the largest reduction in government debt in world history. These results are achieved even though SSA’s official score does not count the likely quite large effects of the reform in increasing economic growth, through increased savings and investment, and reduced taxes. That increased growth would produce more revenues for the transition, which would sharply reduce the need for selling any Social Security trust fund bonds.

“All these tremendous benefits of the reform result because it involves shifting from the enormous, purely redistributive, pay-as-you-go program of today to an enormous real savings and investment program that sharply increases national wealth, income and economic growth ... Such reform not only solves the problems of Social Security, but provides the capital for the technology intensive 21st century economy to leap to a new level.”

Mr. Ferrara, director of the International Center for Law and Economics, is a senior policy adviser on Social Security to the Club for Growth. For more information on Ferrara’s proposal published by the [Institute for Policy Innovation](#), see “[A Progressive Proposal for Social Security Private Accounts.](#)”

LA Times Says Bush will Campaign for Social Security Reform

Edwin Chen, staff writer for the *Los Angeles Times*, regards Bush's commitment and political faith in individual accounts as factors that will contribute to a reelection bid and, eventually, reform legislation in 2005. In "[Bush Now Directing Attention to Revamping Social Security](#)," Chen writes: "President Bush is completing plans to campaign next year for a restructuring of Social Security, a potentially divisive drive that he believes is 'a winning issue' for Republicans—and for his own legacy."

"Bush's goal of allowing workers to divert some of those payroll taxes into private investment accounts faces even more political obstacles than the just-passed Medicare legislation.

"But Bush may enjoy advantages over predecessors who tried to revamp Social Security ... The sense of anxiety over Social Security is mounting as the day of the program's inability to pay promised benefits—now estimated to occur in [2042]—draws closer.

"'Politically, the safest course would be to say nothing about it; historically, Social Security has been a Democratic issue,' said John J. Pitney, a professor of government at Claremont McKenna College. 'But on the other hand, hard-core opposition to Social Security reform has receded, if only because the day of reckoning is getting closer, and most people in their 40s and 50s realize that some kind of change is necessary.'

"When he ran for the White House, Bush embraced an overhaul of Social Security as a central plank of his campaign. A few months after taking office, he named a bipartisan 16-member commission to recommend ways to preserve the program.

"[Bush] often tells listeners, especially at Republican fund-raising events like those in Nevada and Arizona last week, that he does not intend to pass the buck on challenging tasks. 'I came to this office to solve problems, instead of passing them on to future presidents and future generations,' Bush told supporters at the Venetian Hotel and Casino in Las Vegas.

"At the White House, where senior aides have been working to complete Bush's 2004 agenda, deputy communications director Suzy DeFrancis said that 'it shouldn't surprise anyone' when the president begins promoting changes in Social Security in the coming months.

"There is no dispute that, without major intervention, Social Security is headed for insolvency. The annual cost of its benefits represents about 4.4 percent of the gross domestic product. But because America is an aging nation, that is projected to rise to 7 percent of the GDP by 2077 ... Given the number of baby boomers—those born between 1946 and 1964—the payroll tax would need to be 18 percent or more if retirees are to continue receiving the same benefits, unless new ways are found to finance the program.

"When Bush established the Social Security commission in May 2001, he laid out six 'guiding principles' that included no changes for retirees or near-retirees regardless of the commission's recommendations; no increase in the payroll tax; and the creation of individually controlled, voluntary personal retirement accounts, which dovetails with the president's vision of an 'ownership society.'

“Sen. Lindsey O. Graham (R-S.C.), who campaigned on Social Security reform when he ran for the Senate, is circulating a letter on Capitol Hill beseeching fellow lawmakers to avoid using ‘white-hot rhetoric’ against those ‘who discuss reform options openly and honestly.’

“‘Social Security has often been used as a weapon to achieve short-term political goals,’ Graham said. ‘Indeed, both parties seemingly compete to outbid each other in ruling out options for restoring the fiscal health of Social Security. It is time for the demagoguery to stop.’

“Such rhetoric is unlikely to deter Bush, said Pitney of Claremont McKenna College ... This is something he thinks about when he considers his legacy.”

Concord Coalition: Voters Should Expose Candidates that Support a “Do Nothing Plan”

Facing deteriorating fiscal environment as the baby-boom entitlements approach, the Concord Coalition proposes seven [“Key Questions Voters Should Ask Candidates About the Budget, Social Security and Medicare.”](#) The brochure proposes concise questions that citizens and the media should ask candidates for federal office. By so doing, candidates will feel pressure to address these issues if they are elected. Each question is followed by a description of the problem.

Question 6: “Do you support the ‘Do Nothing Plan’ for Social Security? If so, why? If not, what steps would you take to close the program’s long-term funding gap?”

Concord Coalition: “Imagine that a candidate promised to introduce legislation called ‘The Social Security Do Nothing Plan.’ Under this bill, promised retirement benefits would be cut by 16 percent for today’s 30-year-olds, by 29 percent for today’s 20-year-olds and by 35 percent for today’s newborns. Alternatively, payroll taxes would suddenly go up by 34 percent in 2042. With either choice, we would still need to borrow trillions of dollars to pay benefits. How many candidates would campaign for office with such a plan? Probably none, and yet these are the consequences of doing nothing.

“Social Security is the country’s largest government program, comprising 22 percent of all federal spending. Social Security’s revenues, which come mostly from payroll taxes, are more than sufficient to pay benefits in the near term. But changing demographics make the current system unsustainable over the long term. Social Security is generating annual surpluses now, but large and growing deficits loom in the future. Between now and 2018, the program is projected to generate a \$1.1 trillion cash surplus. But from 2018 through 2077, Social Security faces a cumulative cash deficit of \$26 trillion. This change is due to the rapid aging of America’s population.

“Low birthrates are reducing the number of taxpaying workers while longer life spans are increasing the number of beneficiaries. When the boomers were born there were more than five workers per beneficiary. By the time they are fully eligible for benefits there will be two workers per beneficiary. This declining ratio is a problem because current workers pay for the benefits of current retirees. Ultimately, the need for reform is not a matter of ideology. It is a matter of simple arithmetic.

“The Social Security trust fund does show a positive balance through 2042. However, the trust fund is simply an accounting device with ‘assets’ consisting of Treasury IOUs. The cash needed to pay these IOUs will have to come from tax increases, spending cuts, or borrowing from the public, all unattractive options for future policymakers. The key point is that the trust fund assets are also taxpayer liabilities. Their existence on paper does not ease the fiscal challenge of paying future benefits.

“Unfortunately, the window of opportunity to gradually phase in cost saving reforms and have the baby boom generation pre-fund a portion of their retirement benefits is rapidly closing. Given the magnitude of the projected Social Security deficits, it is clear that the failure of our nation’s lawmakers to enact reforms will have dire consequences for future generations. And yet, the most popular reform plan in Washington is still the ‘Do Nothing Plan.’”

Upcoming Events and Announcements

On Wednesday, December 10, Brookings will host a panel of Social Security experts to discuss [“Saving Social Security: Which Way to Reform.”](#) Peter Diamond, institute professor and professor of economics at the Massachusetts Institute of Technology, and [Peter R. Orszag](#), senior fellow of economic studies at the Brookings Institution, are the authors of a new book, [Saving Social Security](#), which presents a new reform plan that combines benefit and revenue adjustments to restore long-term solvency to the program. Other panelists include Maya MacGuineas, co-director of the Retirement Security Program at the [New America Foundation](#), and Edward Gramlich, member of the board of governors for the Federal Reserve System. The Brookings Institution is located at 1775 Massachusetts Avenue, N.W., Washington, DC. The event begins at 10:00 am. Click to [register](#).

Publications

An increased understanding of the current Social Security system’s unaffordable scheduled rise in benefits would help alleviate the impact of political rhetoric circling the Social Security debate. The latest Congressional Budget Office Long-Range Fiscal Policy Brief, [“Measuring Changes to Social Security Benefits,”](#) provides explanations of how such changes would affect the real value of benefits. For example, the brief states: “a policy to reduce benefits for future recipients by 10 percent suggests that benefits would be lower than they are today. However, if benefits would double under current law, a 10 percent cut would still render greater benefits for future recipients. Understanding the implications of benefit changes requires an understanding of how the value of benefits would evolve over time.”

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