



# Social Security Choice

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

A WEEKLY NEWSLETTER ON SOCIAL SECURITY REFORM

WEEK OF DECEMBER 15, 2003

### ***New Social Security Proposals Promise 2004 Debate***

President Bush is expected to promote individual accounts as a central theme in his reelection bid in the coming year. Julie Kosterlitz, a frequent commentator on Social Security and business and economics correspondent for the *National Journal*, writes in her column that the success of Bush's campaign can be greatly attributed to the recent introduction of several attractive reform proposals. Excerpts of Kosterlitz's column, "Social Security in Play in 2004," follow:

"The Bush administration is now hoping to use the 2004 campaign to build support for the president's brand of Social Security reform. At the core of his reform is the idea that individually owned and invested retirement accounts should replace a part of Social Security.

"Aides say that President Bush considers Social Security reform a pressing national issue, and of the big initiatives highlighted in his 2000 campaign, it is one of the few that remain unfulfilled. Getting out in front of an issue that has traditionally favored Democrats is also smart strategy for Republicans, said a senior White House official. 'It's much easier if you're on the offense, if you know the issue and talk about it, than to wait and be beat back into the corner,' the official said.

"The White House is letting Republican candidates know that if they want to run on a ticket with the president, they should be prepared to address Social Security reform. Moreover, the White House and some conservative activists believe that public attitudes may be changing. They cite the experience of roughly half a dozen Senate and a dozen House races in 2002, where Republicans won despite being challenged on their support for private accounts.

"Bush hasn't proposed or endorsed any specific plan, not even any of the three options laid out in December 2001 by a commission he hand-picked to help devise solutions. He will likely campaign only on a set of principles, much as he did in 2000. In this vacuum, others are rushing to lay down markers to help shape next year's debate. In November and December, prominent players and experts from both ends of the political spectrum introduced three new reform proposals.

“One proposal comes from Sen. Lindsey Graham, R-S.C., who during his 2002 campaign withstood Democratic attacks on his support of private Social Security accounts. His proposal, which has been lauded by business groups, builds on one of the plans outlined by the president’s commission. It would allow workers under age 55 to put in an average of about 2.7 percentage points of their total 12.4 percent payroll tax into private accounts. The accounts would supplement Social Security benefits that under his plan would also be substantially smaller than those promised to retirees today.

“Meanwhile, several anti-tax groups, including the Club for Growth and Jack Kemp’s Empower America, have begun rallying around an even more ambitious proposal, drafted by consultant Peter Ferrara, to let individuals divert an average of 6.4 percentage points of their 12.4 percent payroll tax—more than half—into private accounts. Ferrara’s plan, touted in a *Wall Street Journal* editorial earlier this month, claims to offer workers benefits no lower than, and as much as two-thirds larger than currently promised Social Security benefits. Bigger accounts, supply-siders argue, mean more public support.

“Over the course of 75 years, the actuarial projections [from the Social Security Administration] suggest Graham’s plan would actually reduce Social Security’s cash needs by nearly half. ... Graham’s savings come essentially from a trade-off—those who choose private accounts would get lower rates of increase in their initial retirement benefits than what the current system promises.

“Democrats, meanwhile, show no inclination to propose plans of their own. ‘We’re willing to sit down with the president at any moment, but he needs to come up with a viable plan, and not just say he won’t cut benefits and won’t raise taxes,’ said Rep. Robert Matsui, D-CA.

“Liberal academics have tried to fill the void on the left. In mid-December, Peter Diamond of the Massachusetts Institute of Technology and Peter Orszag, a former Clinton administration aide now at the Brookings Institution, unveiled a reform plan designed to restore the program’s finances without changing its basic structure. It explicitly rejects diverting payroll taxes to private accounts, and it also rejects relying on additional infusions of cash from general revenues.

“Instead, the Diamond-Orszag plan focuses on making a philosophical and public policy case for retaining the basic, collectively financed structure of the program, and for essentially splitting the cost of reform between increased payroll taxes and gradual benefit reductions, with both changes targeting better-off retirees. ... Under their plan, payroll taxes would rise slowly from 12.4 percent in 2005—split as it is today between employer and employee—to 14.2 percent in 2055. ... Like the two conservative plans, this plan was found by the Social Security actuaries to achieve sustainable solvency for the foreseeable future.”

### ***New Study: Faster Growth Doesn’t Help Social Security***

Neither the direct nor the indirect effects of economic growth can save Social Security from insolvency, according to the latest *Issue in Brief* from the Center for Retirement Research at Boston College. In [“Can Faster Growth Save Social Security?”](#)

Urban Institute senior fellow Rudolph G. Penner argues that a growth, and even the richer society that ensues, does not solve Social Security's long-term financial shortfalls. Penner's main arguments follow:

"In 1977, the Congress made a philosophical decision that a person's initial real benefits should be increased automatically as average real wages increased throughout the economy. The Congress wanted to ensure that Social Security recipients enjoyed some share of the benefits of economic growth. The goal of the current indexing formula is to keep the replacement rate constant on average for successive age groups. The replacement rate is defined as the ratio of initial benefits to pre-retirement earnings. While initial benefits are indexed to wage growth during a participant's worklife, afterwards they are indexed only for inflation using the Consumer Price Index (CPI), which means that real benefits are kept constant after individuals first begin to receive them.

"If the economy grows faster, so do worker's wages. Such growth has two different effects on Social Security's finances. Initially, higher growth increases payroll tax receipts but not payments to those already retired, since their benefits are only indexed to inflation. Over time, however, growth in wages also raises initial benefits for the next generation of retirees, which erodes the positive effect of greater tax revenues. On balance, higher growth has only a modest beneficial impact on the financial health of the system and that beneficial impact occurs only because those already retired do not share in the benefits of growth.

"Social Security's Trustees have traditionally measured the financial health of the system by the gap between the present value of promised benefits and payroll tax revenues over the next 75 years. In the 2003 Trustees' report, the program's actuaries estimated this gap to be 1.92 percent of the payroll expected over the projection period. The projected wage growth underlying this projection assumes labor productivity growth of 1.6 percent.

"The Social Security Trustees perform sensitivity tests to determine the importance of changing their economic and demographic assumptions. They show that an increase in real wage growth of 0.5 percent per year would reduce the actuarial deficit in the system by 0.51 percent of payroll. With such an increase in wage growth, the trust funds would be empty in 2049—only seven years later than under the intermediate assumptions used as a base case.

"But how likely is it that actual real wage growth will be higher than assumed by the Trustees, thus mitigating future problems to some degree? Over the past half century, the Congressional Budget Office's (CBO) estimate of potential labor productivity growth was 1.73 percent per year, only 0.13 percent per year above the Trustees' 1.6 percent assumption.

"CBO assumes that the productivity growth rate over the next 10 years will be 1.97 percent per year. This projection is slightly higher than the historical average as the nation continues to apply the fruits of recent, extraordinary technological advances in communications and computing. But even if such a high productivity growth rate were to continue for 75 years—and that seems unlikely—Social Security would continue to have significant financial problems.

“Although it is implausible to assume that increased economic growth can preserve the financial health of the Social Security system indefinitely, it is conceivable that increased growth can make necessary policy changes less painful. These policy changes could include raising taxes, reducing the growth rate of Social Security benefits, or restraining growth in other government programs.

“One could argue that the public will become more tolerant of increased federal tax burdens as people become richer. However, the record of the past 50 years provides no support for this hypothesis. Figure 2 shows that the tax burden has been remarkably constant since the late 1940s, even though the standard of living has approximately tripled over this period. Every time the overall tax burden has exceeded 19 percent of the nation’s economic output (known as the gross domestic product or GDP), Congress has enacted a substantial tax cut, most recently in 2001.

“Given that future tax increases would imply a radical break from the past, could it be argued that the rate of growth of the real value of Social Security benefits need not be as fast if living standards improve? In other words, replacement rates might be allowed to erode so long as the absolute living standards of retirees are not cut. Current payroll tax rates are, in fact, sufficient to finance small increases in average real benefits for at least the next 30 years.

“Acceptance of lower replacement rates would also require a significant change in political attitudes. As noted earlier, the system is firmly based on the value judgment that replacement rates should be held constant over time. In the current political debate, any reduction of replacement rates is referred to as a cut in benefits even if the reduction is slow enough to allow the living standards of the retired population to grow absolutely.

Thus, the authors conclude, “Given the pending demographic pressures on the federal budget, we face a serious problem. Increased growth cannot save us from breaking strong historical precedents. Either the overall tax burden has to rise above the levels of the past, or the growth in benefits for the elderly has to slow compared to what is now promised. ... Enhanced economic growth is obviously beneficial, but it cannot be beneficial enough to solve the demographic problems confronting the federal budget.”

### ***AARP Ducking out of Social Security Debate***

Facing backlash from democrats in Congress over their support of the Republican Medicare prescription drug legislation, “AARP... is backing out of Social Security forums it agreed to sponsor with the Bush administration and from a group advocating a system overhaul to allow stock market investing,” [writes](#) Leigh Strobe, staff writer for the *Associated Press*. AARP’s retreat signals the growing consensus that, eventually, Social Security reform will involve individual accounts—accounts that AARP rules out as an option.

“After inquires from the *Associated Press*, AARP notified participants Monday afternoon that it was dropping out on the ground that the forums would be too politically charged in the aftermath of the Medicare flap. Social Security, like Medicare, is always a hot-button, divisive issue in elections.

“David Certner, AARP’s federal affairs director, said the organization decided the forums were too close to next year’s election. ‘It was simply easier for us to be doing our

own events and not be connected to groups with partisan agendas,' Certner said, adding that AARP wanted to 'avoid the politics of it as much as anything.'

"The nation's largest advocacy group for older Americans already faces a backlash from some members for endorsing the Republicans' Medicare legislation. The support of AARP, whose 35 million members make it a powerful political force, helped the GOP win passage of the bill, which President Bush signed into law last week.

"The Bush administration, with the stock market climbing and a re-election campaign under way, is renewing its push for an overhaul of Social Security to allow personal investment accounts, a move supported by the manufacturers' association.

"The planned forums were a major part of the administration's strategy to start a public dialogue about the need to shore up future funding of the pay-as-you-go system, which in 2018 should begin to pay out more in benefits than it collects from workers' payroll taxes.

"AARP's participation would have helped give credence to the administration's argument that reform is necessary. AARP has tried for years to educate all Americans about the future financial problems the system faces.

"The group supports the concept of personal investment accounts, but only if they are added to the system without diversion of money that pays for Social Security's traditional benefits. AARP opposes the Bush administration's plan to let younger workers, whose payroll taxes now fund current retirees' benefits, divert a portion of that money into their own investment accounts."

### ***National Journal Lists Top Social Security Websites***

With Social Security reform promising to be a hot election topic in 2004, voters should be equipped with the latest research and policy analyses to form an opinion on individual accounts. Julie Kosterlitz, business and economics correspondent for the *National Journal*, comments on the top sources for information on Social Security reform:

"The official Web site of the Social Security Administration [[www.socialsecurity.gov](http://www.socialsecurity.gov)] ... provides interesting information about the program's history and the statistics, actuarial projections, and research that feed the policy debate about Social Security's future.

"Congress's watchdog agencies, the Congressional Budget Office [[www.cbo.gov](http://www.cbo.gov)] and the General Accounting Office [[www.gao.gov](http://www.gao.gov)], provide thorough, nonpartisan analyses of Social Security's impending financial problems, their effects on the budget and the economy, and the tough choices required for any fix ... The shorter CBO briefs are just terrific—very balanced as well as digestible for the non-Social Security expert." See "[Measuring Changes to Social Security Benefits](#)," "[Comparing Budgetary and Trust Fund Measures of the Outlook for Social Security and Medicare](#)," "[The Future Growth of Social Security: It's Not Just Society's Aging](#)," and "[Social Security Reform: The Use of Private Securities and the Need for Economic Growth](#)."

"'Actuary,' like 'accountant,' is a word guaranteed to stop cocktail chatter dead. But the Web site of the American Academy of Actuaries [[www.actuary.org](http://www.actuary.org)] is not only

evenhanded on the polarizing issue of Social Security reform, it manages to make the issue downright entertaining. Playing the '[Social Security Game](#)' lets you choose from the key list of reform options, read the pros and cons for each, then see how far each choice takes you toward solving the program's problems." See "[Raising the Retirement Age for Social Security](#)," "[Social Security Reform: Voluntary or Mandatory Individual Accounts](#)," and "[Automatic Adjustments to Maintain Social Security's Long-Range Actuarial Balance](#)."

"The libertarian Cato Institute has for decades championed replacing part of Social Security with private investment accounts, and it has a snazzy Web site [[www.socialsecurity.org](http://www.socialsecurity.org)] to advance its views. It's a good window on the free-market approach to reform. Most useful, though hardly objective, is the weekly e-mail newsletter on developments in the policy and political debate over reform." See recent [policy analysis papers](#), "[Perspectives on the President's Commission to Strengthen Social Security](#)," "[The Better Deal: Estimating Rates of Return under a System of Individual Accounts](#)," and "[Large Accounts and Small Cash Deficits: Increasing Personal Account Size within a Fiscally Responsible Social Security Reform Framework](#)."

Many liberal advocacy groups have let their Social Security websites lapse. Now, conservative newcomer For Our Grandchildren [[www.fourgrandchildren.org](http://www.fourgrandchildren.org)] is making its site an integral part of an aggressive campaign to promote replacing part of Social Security with private accounts. Launched just over a year ago with a hefty grant from Oregon window-manufacturing magnate Dick Wendt, the group includes a Who's Who of the private-accounts movement. Besides offering links to Cato Institute reports and current news articles, the site incorporates many of the cutting-edge features—online fundraisers, [Web logs](#), animated cartoons, e-mail alerts—being used so effectively by Democratic presidential contender Howard Dean.

"The Center on Budget and Policy Priorities [[www.cbpp.org](http://www.cbpp.org)] is a left-of-center research outfit that churns out lucid and well-documented analyses of the effects of policy proposals, including those involving Social Security, on low-income Americans. The group's research supports its view that most privatization proposals are bad news for the needy—and are costly, to boot." See "[Low Wage Earners: Options for Improving Their Retirement Income](#)."

"AARP [[www.aarp.org](http://www.aarp.org)], the premier advocacy and consumer group for Americans age 50 and over, has serious doubts about replacing some parts of Social Security with private personal investment accounts. The site plainly lays out AARP's views, and it provides links to current events in its newsletter, to testimony and speeches by AARP officials, and to in-depth studies by the group's research arm." See "[Have Plunging Stocks Killed Private Accounts in Social Security?](#)" "[Payday: Sooner or Later?](#)" "[Individual Accounts: Lessons from Sweden](#)," and "[Global Report on Aging](#)."

"For the serious policy wonk, it's hard to beat the Web sites of Boston College's Center for Retirement Research [[www.bc.edu/centers/crr](http://www.bc.edu/centers/crr)] and the University of Michigan's Retirement Research Center [[www.mrrc.isr.umich.edu](http://www.mrrc.isr.umich.edu)]. Each has cutting-edge research on Social Security, the private pension system, and the economic, demographic, and behavioral factors affecting retirement. Boston College's site is a bit more graphically appealing and user-friendly." See "[Can Faster Growth Save Social Security?](#)" and "[How Has the Shift to 401\(k\)s Affected the Retirement Age?](#)"

**Note:** *Social Security This Week* will not be published on December 26 or on January 2. The staff of Cato's Project on Social Security Choice wishes you Happy Holidays and a wonderful New Year.

**Edited by Helen Mitchell, [hmitchell@cato.org](mailto:hmitchell@cato.org). To subscribe or unsubscribe to *Social Security This Week*, please contact Feliz Ventura at (202) 789-5202 or [fventura@cato.org](mailto:fventura@cato.org).**