



Social Security Choice

SOCIAL SECURITY THIS WEEK

A WEEKLY NEWSLETTER ON SOCIAL SECURITY REFORM

WEEK OF MAY 7, 2004

Crane May Head Social Security Panel in 2005

Rep. Phil Crane (R-IL) is on tap to become chairman of the Social Security Subcommittee of the Ways and Means Committee in 2005, according to a report in *Congressional Quarterly*. The move would put Crane, a longtime supporter of individual accounts, in a key role if President Bush is reelected and pushes for Social Security reform next year.

Current subcommittee chairman Clay Shaw (R-FL) is term-limited as chairman and reportedly wants to take over Crane's position as chairman of the Subcommittee on Trade. Crane has expressed some interest in remaining in his current position, but it would require a waiver of term-limit rules, which is considered unlikely. If Crane stays put, other names mentioned as potential Social Security Subcommittee chairs include Rep. Nancy Johnson (R-CT), Rep. Jim McCrey (R-LA), and Rep. Sam Johnson (R-TX).

Kondracke: Bush and Kerry Must Provide Leadership on Social Security Reform

Morton M. Kondracke, writing this week in *Roll Call*, points out that neither George W. Bush nor John Kerry has demonstrated sufficient leadership on the single most important domestic problem facing America: fixing the ailing Medicare and Social Security programs. In the article, which follows, Kondracke argues that there are creative and innovative solutions to the programs' problems on the table (including personal retirement accounts) and there are those members of Congress willing to discuss the matter, but Bush and Kerry seem to be willfully ignoring it.

"The Bush and Kerry campaigns are playing the public for fools, avoiding one of the biggest questions in America's future: how to finance the retirement of the baby boom generation.

"It's a monstrous problem that will either break the American economy or—if addressed creatively and soon—revitalize it. Demographically, there is no avoiding the crisis, even if current politicians are scared to death about tackling it.

“The boomers, 77 million of them, will begin retiring in just six years, drawing huge Medicare and Social Security benefits. Right now, the taxes of just three workers support the benefits payable to each current retiree, compared to 16 workers back in 1950. When most of the boomers are retired, the burden will be carried by just two workers.

“The choice is simple. Cut the benefits, tax the hell out of the boomers’ children—or figure out better ways of sharing the burden.

“In fact, some good (if controversial) ideas have been proposed, many at the New America Foundation, an independent centrist think tank. They include lifetime savings accounts, means-tested Medicare, a policy of stimulating healthier lifestyles and less-costly but better-quality medicine, and efforts to encourage greater birth rates and higher immigration levels to grow the nation’s population.

“A few Members of Congress have picked up on some of the ideas, but Bush and Kerry, instead of leading, are running away from the problem.

“Federal Reserve Chairman Alan Greenspan in February only had to mention the prospect of changing the basis of calculating benefits before howls went up from Democrats. President Bush promptly dove for the tall grass.

“Democratic presidential candidate Sen. John Kerry (Mass.) said that ‘the wrong way to cut the deficit is to cut Social Security benefits.’ His then-Democratic rival, Sen. John Edwards (N.C.), pronounced Greenspan’s remarks ‘an outrage.’

“President Bush, who has occasionally shown a touch of courage on such matters, rushed to assure retirees and near-retirees that he wouldn’t cut their benefits, either.

“But the problem won’t go away. The trustees of the Social Security and Medicare systems reported in March that Social Security’s surplus will disappear in 2015 and that Medicare will run out of money in 2019, seven years earlier than was forecast just a year ago. (Bush’s prescription drug proposal was the main culprit.)

“The Congressional Budget Office reported that, without policy changes, the combined cost of Social Security, Medicare and Medicaid could rise from 8.3 percent of GDP last year to between 14 percent and 17 percent in 2030 and between 19 percent and 27 percent in 2050. All of government currently accounts for about 20 percent of GDP.

“Because of exploding health care costs, Medicare and Medicaid represent 10 times the long-term problem that Social Security poses, according to the CBO.

“From time to time, President Bush has suggested a viable approach to the overall problem—one with the theme of ‘the ownership society,’ in which people would be helped to save and finance their own health care, education and retirement.

“Kerry has nothing comparable, or positive, to offer. Instead, he criticizes Bush—legitimately—for tax-cutting the country into deficits and debt that will burden future generations and—illegitimately—for wanting to ‘privatize’ Medicare and Social Security.

“With a few exceptions—Rep. Harold Ford Jr. (Tenn.) and Sen. John Breaux (La.) among them—Democrats fight rigidly to maintain and expand existing entitlement programs even if they will bankrupt America’s children. Kerry is not in the reform camp.

“In the meantime, Bush has failed to make the ‘ownership society’ a mainstay of his campaign—not spelling it out in his State of the Union speech, for instance—and has concentrated instead on foreign policy, especially on Kerry’s weak voting record on defense.

“This is a legitimate issue, except when House Republicans call Kerry ‘Hanoi John’ and accuse him of ‘aiding and abetting the enemy’ for protesting the Vietnam War in the 1970s—as if he’d never won a Silver Star.

“Bush ought to be telling the country what he’s going to do in his second term. The closest he has come was in speech to the Republican Governors Association this winter:

“‘My administration understands the importance of ownership in our society,’ he said. ‘We have set a great goal. We want every worker in America to be a saver and an owner. ... We’ll help more people, of every background, own their own homes and build their own savings.

“‘We’ll help more people to own their small businesses ... [and] health care plans. We want younger workers to own and manage their own retirement. ... I believe in private property so much, I want everyone in America to have some.’

“It’s a heady concept that has yet to be spelled out, let alone introduced as actual legislation. And, it entails big challenges. Bush’s gigantic tax cuts and deficits make it practically impossible to finance an ‘ownership society.’ And most of his benefits go to people who pay income taxes, not to the millions who pay mostly, or only, regressive payroll taxes.

“Ford and Sen. Lindsey Graham (R-S.C.) have proposed a novel Social Security reform plan that involves reducing benefit growth and giving workers under 55 the option of staying in the current plan and paying higher taxes, paying current tax rates and receiving only the benefits that they will earn, or establishing a personal savings account with a portion of their payroll taxes.

“Ford also supports the New America Foundation’s idea of establishing a savings account for every child, untouchable until age 18, that would give every American a stake in the economy, encouraging savings—that is, investment capital.

“The NAF’s Phil Longman, in a new book, *The Empty Cradle*, warns that current dicey projections about the solvency of U.S. retirement programs are premised on maintaining the current U.S. birthrate and immigration levels—at a time when birthrates in all industrialized countries (as well as Mexico) are plummeting.

“To keep solvent, he argues, the United States needs to get medical spending under control—mainly by encouraging healthier lifestyles—and encourage population growth, partly by making work and family life easier to juggle.

“Do you hear President Bush or John Kerry talking about any of this? Obviously not. They are thinking only as far ahead as November.”

Lawrence Kudlow: *Wealth and Retirement Prosperity with PRAs*

Syndicated columnist Lawrence Kudlow had [an opinion piece](#) in Sunday's *Washington Times* on the benefits of making Social Security a system of personal retirement accounts. (Kudlow had a similar piece in last Friday's *Investor's Business Daily*.) Using a Cato Institute study as evidence, Kudlow dismissed critics of PRAs who claim that the stock market is simply too volatile to be depended on for retirement income. On the contrary, he argues, letting Americans invest their retirement funds makes workers into owners; it will generate far more wealth and prosperity for all Americans and their families than traditional Social Security could ever promise. The text of his article follows:

“Imagine if every worker in the United States had the opportunity to become an investor. Well, that dream has a shot at reality.

“In his 2004 State of the Union address, President Bush suggested workers be allowed to redirect part of their payroll taxes into individual retirement accounts (IRAs). That was a big statement. It means there's now a legitimate chance to transform Social Security from a financially bankrupt system into a source of real ownership and prosperity for all Americans.

“Many Americans are investors, but not all. Federal Reserve reports 31.6 percent of households owned stock either directly or indirectly in 1989. By 2001, it was 51.9 percent.

“Since the Reagan presidency, the U.S. has made great strides toward democratizing capitalism by reducing marginal tax rates, deregulating the financial-services industry and creating savings vehicles like IRAs and 401(k)s. Mr. Bush's latest proposal for Lifetime Savings Accounts is another step in the right direction.

“That said, the greatest impediment to saving, investing, creating wealth and retiring prosperously is still the payroll tax—which now is 12.4 percent. Each payday workers see half of that go to today's retirees as well as many government programs. This depletes household savings and diminishes wealth, leaving too many Americans dependant on the government for retirement income.

“When discussing even the idea of personal retirement accounts, skeptics always point to the volatility of the stock market. What they fail to realize is that Social Security is riskier than the market will ever be. The government can at any time raise taxes or cut benefits. Moreover, workers born after 1960 are expected to receive a real rate of return on their payroll-tax contributions of less than 2 percent. Alan Greenspan stated this in 1999; his estimate likely was generous.

“This measly return (actually negative for African-Americans, a group with high mortality rates) is not a fair deal for retirees—today or in the future. Even workers who put their money in standard government-insured savings accounts will earn higher returns than the current Social Security system can provide.

“But there’s an alternative. According to a study by the chief actuary of the Social Security Administration, a worker with a large personal retirement account can expect a return *60 percent greater* than promised under the current system. [A Cato Institute study](#) shows that, even in the worst 20-year period for stocks (1929 to 1948) the market’s average return was 3.36 percent, better than Social Security promises today.

“Dissenters also cite the collapse of Enron as further evidence the stock market is a ‘risky scheme.’ To the contrary, the Dow Jones closed at 9,736 the day after Enron’s bankruptcy was announced in December 2001. Today it hovers around 10,300.

“Investors, who are 2 out of 3 voters, have demonstrated by perseverance amid short-term shocks they know the market is an immense source of long-run wealth. The investor class can vouch for the common sense of personal retirement accounts.

“It’s interesting that many who adamantly oppose personal retirement accounts already have their personal pensions in the stock market. In fact, state and local governments have been investing pension money in private stocks and bonds for generations. Members of Congress and other federal workers also can invest in private markets. Why can’t ordinary people?

“They should. IRAs are not a risk, but a historic opportunity to increase prosperity for all.

“The question remains ‘How?’ But the Alliance for Retirement Prosperity has an excellent answer. This group—led by former congressman and Housing and Urban Development Secretary Jack Kemp, former House Majority Leader Dick Armey, and former Social Security Commissioner Dorcas Hardy—is devoted to enacting legislation to let Americans invest at least half of their payroll taxes in personal retirement accounts.

“Their proposal would in effect make the government the plan sponsor, putting appropriate funds on the table and guaranteeing something like a death benefit if individuals lose money over 40 years. In the unlikely fall of market performance below promised Social Security benefits, government provides the difference. If, as is likelier, investment-market performance exceeds Social Security returns, investors pocket the gain.

“This plan—vacant of draconian tax increases or benefit cuts—is on the money. Today there’s a small window of opportunity for transforming Social Security into a vehicle that creates wealth and retirement prosperity for individuals, households and communities. All Americans can have the chance to realize the American Dream if every American becomes an investor and every worker an owner.”

For more information on the rate of return during an economic slowdown, see [“Personal Accounts in a Down Market: How Recent Stock Market Declines Affect the Social Security Reform Debate,”](#) by Andrew Biggs, Cato Briefing Paper no. 74, September 10, 2002.

Kotlikoff: Social Security Liabilities Could Lead to Hyperinflation

In the upcoming edition of *Fortune* magazine, due out on May 17, economist Laurence Kotlikoff points to yet another potential problem with putting off Social Security reform: hyperinflation. Kotlikoff, coauthor of *The Coming Generational Storm*, a book detailing the bleak economic future of Social Security, argues that although hyperinflation can be controlled to some extent by the Federal Reserve, a combination of factors will soon create the perfect conditions for hyperinflation that the Fed simply cannot control. As he describes in the following excerpt, one important step to heading off this looming economic disaster is immediate entitlement reform.

“It’s one thing [for the Fed] to convince markets that inflation will stay low when you’re running surpluses and everyone believes your fiscal house is in order, and another when you’re reporting \$500 billion deficits, dramatically raising federal spending, cutting taxes like mad, and facing a tidal wave of bills associated with baby-boomer retirement. Countries that can’t cover their spending with taxes or via further borrowing are forced to do so by either printing cash or creating money electronically. And more money chasing the same goods ultimately means higher prices.

“Like other governments, ours engages in a sleight of hand when it makes money by making money. In creating money to cover expenditures, Uncle Sam has the Treasury sell bonds for the needed amount to the public, and then the Fed buys the bonds right back with either fresh cash or an electronic bank credit. The result is the same as if the Fed simply gave the Treasury the money directly.

“If a country’s fiscal gap—the difference between its planned future spending (including debt service) and its projected future taxes—is massive, the government will eventually have to really crank up the manual and electronic printing presses to cover the difference. At that point, something extremely scary can happen: hyperinflation.

“Printing money to pay unaffordable bills dates at least to Emperor Diocletian, who ran what may be the nastiest case of hyperinflation in world history. In the last century, two dozen countries hyperinflated, the most famous (although hardly the worst) example being Germany during the 1920s. Reducing real spending this way is ugly, but it works, provided nominal spending isn’t indexed to price levels. In the U.S., over the past 20 years most federal expenditures have been indexed. Hence, using inflation here to cut real spending requires outpacing indexation, which accelerates price increases even more.

“But can’t the Fed always raise interest rates a lot to keep inflation in check? Nope. When the Fed is faced with a choice of (a) defaulting on federal government debt and failing to pay critical bills like Medicare and Social Security or (b) printing money, it has to go with (b). And by so doing, it creates a nightmare scenario: Interest rates, out of the Fed’s control, now reflect the prevailing inflation rate, which in turn is determined by the rate of new-money creation, which is itself on autopilot. The reason interest rates reflect inflation is that lenders need to be compensated for implicit default (i.e., paying creditors in watered-down dollars).

“Hyperinflation is a real and present danger for the simple reason that the U.S. government is effectively bankrupt. Its fiscal gap is \$51 trillion, when measured as a present value. That’s 11.6 times official debt, 4.5 times GDP, and 1.2 times private net wealth. Coming up with \$51 trillion without a printing press would require, immediately and permanently, either hiking federal income taxes 78%, cutting Social Security and Medicare benefits 51%, or eliminating more than 100% of federal discretionary spending, which ain’t easy. And waiting only makes matters worse.

“That is America’s menu of pain. When investors around the world wake up to U.S. insolvency, it will be extremely expensive for our government to borrow. The only option then will be printing huge sums of money—generating exactly the hyperinflation the bond market has decided to expect.

“The one way to avoid code red is immediate and very painful entitlement reform—precisely the thing leaders in Washington don’t want to talk about. Economics isn’t called the dismal science for nothing.”

Publications

A new World Bank report entitled “Keeping the Promise of Old Age Income Security in Latin America” evaluates the transition of several Latin American countries from pay-as-you-go pension systems to systems based on private accounts. The report discusses issues such as overall coverage, effects on social welfare, capital market development, and options that may improve the countries’ respective systems. Among the overall effects, the report notes that the transition to private accounts has decreased government liabilities, increased private savings, and contributed to the creation of healthy financial markets. According to the report’s foreword, while the current pension systems in Latin America have some areas in which they can be improved, the reforms have brought “many successes in delivering fiscal, financial, and social benefits.” To view the full report, click [here](#).

The RAND Corporation addresses Europe’s challenging demographic issues in a recently published study entitled “Low Fertility and Population Ageing: Causes, Consequences, and Policy Options.” The study examines the relationships between different policies and demographic trends throughout Europe—a continent that is currently experiencing significant ageing of its nations’ populations. Though policies promoting replacement immigration and the introduction of childbearing incentives might have a limited effect on demographics, it is expected that pay-as-you-go pension systems in Europe, among other social insurance programs, will continue to be “heavily burdened” as an even smaller workforce will be obligated to pay benefits to a growing number of retirees. Click [here](#) for the full text of the study

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.