

Social Security Choice

SOCIAL SECURITY THIS WEEK

A WEEKLY NEWSLETTER ON SOCIAL SECURITY REFORM

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Cato Announces Nobel Laureates Backing of Social Security Choice

More than 450 of America's top economists, including Nobel laureates Milton Friedman, Robert Lucas, Robert Mundell, Edward Prescott, and Vernon Smith, are calling for the nation's troubled Social Security system to be reformed by giving workers the option of shifting all or part of their payroll taxes into privately invested accounts.

In ads sponsored by the Cato Institute *Roll Call* newspaper and the *Washington Times*, the economists argue that America's Social Security system is facing a financial crisis because of its flawed pay-as-you-go structure. They say that any solution "must uphold the time-honored principles of ownership, inheritability and choice."

Demographics have made the current system unsustainable, they say in Cato's *Petition: Concerning the Future of Social Security*. "In 1950 there were 16 workers paying taxes to support every person collecting benefits. Today there are only 3.3; by 2040 there will be just 2," they argue, adding: "Further, as economists we understand the crucial role private ownership plays in allocating resources and creating a rational framework for decision making."

The ads appeared just hours before the House Ways and Means Committee held its first hearing on Social Security reform. Among those testifying before the panel was Michael Tanner, the director of the Cato Institute's Project on Social Security Choice.

The Cato Institute will also begin running adverts next week in major opinion and political publications, including the *New Republic*, *National Review*, *Reason* and the *Weekly Standard*, outlining the real issues of Social Security reform and maintaining that the crisis engulfing the current system presents a great "opportunity to build a new and better retirement program for all Americans."

Debate Moves Forward with Bill Thomas at the Helm

On Thursday, Cato's Mike Tanner testified before the House Committee on Ways and Means on Social Security reform. Tanner told the committee, "Under the current Social Security system you have no legal, contractual, or property rights to your benefits. Under Cato's proposal, workers under the age of 55 would have the option of diverting

their half of the Social Security payroll tax (6.2 percent of wages) to an individual account. The employer's portion of the payroll tax would continue to be paid into the Social Security system to provide survivors and disability benefits, as well as to partially fund continuing benefits for those already retired or nearing retirement."

The debate was widely described as a big first step in the legislative process of reform. As such, partisan volleying between committee members was high. Democratic opposition to personal retirement accounts remains unbroken, though many pundits and politicians have publicly placed their faith in committee chair Bill Thomas (R-CA). According to the [New York Times](#), Thomas "expressed optimism after the session and indicated he was still pushing ahead to produce legislation this summer. Mr. Thomas indicated that he remained committed to dealing with Social Security in a broader legislative package that would also deal with retirement security in general—from private pensions to more encouragement for people to save in I.R.A.'s or 401(k)'s."

Thomas is well known for his ability to create broad-based support for large package bills. Supporters of reform can certainly remain hopeful that his attempts to broaden the debate on Social Security will bring in support from fence sitters in Congress and the business community, as well as voters. Thomas also has been a supporter of large personal retirement accounts in the past.

However, concerns remain that the quality of the legislation might be compromised in the process of deal making, as was the case with Thomas's leadership on the recent Medicare prescription drug overhaul. According to Lawrence Hunter of the Free Enterprise Fund, "I think he may be correct that if you expand the field you may be able to get more support. My only caution would be that we keep it simple on Social Security."

Featured Daily Debunker: Johnson Bill Doesn't Offer a Free Lunch

Each weekday, the Cato Project on Social Security Choice provides new content on its website, www.socialsecurity.org. The Daily Debunker, the most frequently updated feature on the website, sets the record straight about the most egregious instances of misinformation about personal accounts that appear in newspapers and magazines. This week's featured debunker, from Friday, May 13, takes on a recent article in the *Washington Post*. From the Debunker:

In an attempt to convey a sense of disarray among supporters of personal retirement accounts in Friday's *Washington Post*, [Jonathan Weisman claims](#) H.R. 530, the Sam Johnson bill, contains elements that might, in the words of one White House political aide, "cause an economic chain reaction."

"You may know that there is a small number of conservatives who prefer to push only for investment accounts and make no effort to adjust benefits,' White House political aide Peter H. Wehner wrote conservatives in a January e-mail. 'This could easily cause an economic chain reaction: The markets go south, interest rates go up, and the economy stalls out.'

"Not all Republicans are buying the argument. Two Ways and Means Committee Republicans, Reps. Paul Ryan (Wis.) and Sam Johnson (Tex.),

have written separate large-accounts proposals. Ryan's would establish accounts as large as 10 percent of wages, then guarantee that beneficiaries would receive at least the Social Security benefit level currently promised."

Weisman's characterization of the Johnson bill, however, is wrong. Whatever the merits of Peter H. Wehner's economic analysis, it is untrue to claim the measure written by Rep. Sam Johnson avoids any adjustment of benefits. The Johnson bill is perfectly consistent with the prevailing view that the current benefit structure will need to be amended and supplemented with personal retirement accounts. The Johnson bill would change the indexing formula upon which benefits are measured from a wage-based index to a price-based index and would allow workers to invest their half of the Social Security payroll tax into personal accounts.

If you would like to get the straight facts on the various Social Security reform measures before Congress, you can use the Cato Institute's [matrix](#), which allows you to compare up to three different bills at a time.

Two CBPP Papers Jump to Dubious Conclusions

The Center on Budget and Policy Priorities released two reports this week by Jason Furman, a senior fellow specializing in Social Security issues. The key findings of both were swiftly rebutted by both the White House and scholars at the Cato Institute.

In the first report, "[New White House Document Shows Many Low-Income Beneficiaries Would Face Social Security Benefit Cuts Under President's Plan](#)," Furman indicated that the president's proposal would disproportionately impact widows, children survivors, and divorced women in the lowest quintile of earners if the deceased worker to whom their benefits are tied was not in the bottom 30 percent of the income distribution. That is, people whose benefits are tied to the higher income of a deceased or former spouse will be scheduled to receive less than people whose benefits are tied to lower incomes, even if the recipient is a survivor who doesn't make very much money.

On its face, that is an excellent argument for eliminating some of the inherent inequities in the system by implementing a system of personal savings for retirement—traditional Social Security is not a system that was designed to deal with high divorce rates or women in the workplace. Tying a woman's benefits to her husband's earnings no longer makes sense from a policy perspective.

But apart from highlighting this inequity, Furman's claims and conclusions are somewhat dubious. He compares benefits from the president's plan to benefits promised by the current system, which are promises that can't be kept. Additionally, Furman fails to point out that even among beneficiaries whose scheduled benefits are reduced, their benefits in constant dollars will continue to rise. The White House released a rebuttal to Furman's claims, showing that divorcees, widows, and dependent children survivors actually fare much better under the president's plan than they would from progressive indexation alone or from what the current system will actually be able to pay.

According to the White House rebuttal, “CBPP focuses only on one part of the President’s proposal—progressive benefit growth—while ignoring the essential role played by personal accounts. Under personal accounts, the largest benefit increases often go to the most vulnerable Americans, such as widows and divorced individuals. Accounts can be passed on or split at death or divorce, giving widows, divorced women and surviving children the opportunity to build larger account balances.”

In a second report from the CBPP, “[The Impact of the President’s Proposal on Social Security Solvency and the Budget](#),” Furman argues that the president’s plan to introduce progressive indexation along with personal retirement accounts would not have the intended effect on solvency. Furman claims that the plan would continue adding to the debt until 2054 and that the debt would not stop causing the debt to be higher than it otherwise would be until 2067.

But according to Cato senior fellow Jagadeesh Gokhale, the awkward wording of Furman’s analysis highlights the report’s main flaw: the report doesn’t address what will happen *after* 2067. According to Gokhale, “First, the president’s plan would generate large surpluses after 2067—leading to improved solvency through 2079. Second, the paper looks only at federal debt without counting the assets accumulating in personal accounts. Counting those assets as part of the Social Security system’s assets, would make total debt lower much before 2067.”

Gokhale also commented on the misleading claim that the president’s plan would only solve 30 percent of the solvency problem within the actuarial window. Again, says Gokhale, Furman has neglected to look beyond the somewhat arbitrary 75-year estimates.

“Many observers seem to believe that 75 years is long enough for an evaluation of Social Security’s finances,” according to Gokhale. “However, 75-year actuarial windows are misleading as measures of the system’s financial condition. They count the taxes paid by workers over the next 75 years but exclude the resulting accrual of benefit obligations beyond the 75th year.”

“If evaluated over a much longer period, the president’s plan would fix a much larger percentage of the program’s solvency. For example, if the president’s plan also improves the system’s finances in years 76–100, we will have a smaller financial shortfall to fix after another 25 years when the deficits in the latter years fall within the 75-year window. By ignoring the shortfalls beyond year 75, we are tacitly assuming that they are zero. By not accounting for and fixing the program’s finances over a much longer period of time, we would increase the ultimate economic cost of operating the program.”

Estelle James: Reform Should Avoid Excessive Debt Financing

At a House Financial Services Domestic and International Monetary Policy, Trade and Technology Subcommittee hearing late last week, Estelle James, a former World Bank economist, strongly cautioned Congress against financing personal accounts through excessive borrowing. Though James is a staunch supporter of personal accounts, she expressed concerns about the president’s plan to finance the transition by

borrowing an estimated \$754 billion over the next ten years and additional trillions after that, according to *CQ Today*, a publication of *Congressional Quarterly*. James said that lawmakers should “come up with a transition financing plan that does not rely excessively on debt financing.”

In its work on Social Security reform, the Cato Institute has repeatedly suggested that transition financing should be covered in part by the employer portion of the payroll tax, cuts in discretionary spending, and cuts in corporate welfare. In a [2003 commentary](#), for example, Andrew Biggs and Maya MacGuineas cited a 1998 *Time* magazine report that found that corporate welfare and tax loopholes cost taxpayers \$125 billion annually. Ending government handouts to corporations could provide a large chunk—if not all—of the cash needed to fund the transition.

Reform Opponents Manipulate United Airlines Pension Default

As reported in *CQ Today*, Democratic lawmakers and other opponents of reform have seized on the pension default of United Airlines as an argument against personal accounts and the introduction of risk into Social Security. According to the news brief from *CQ*, “Democrats moved quickly Wednesday to conflate the two issues, saying that insecurity in private pensions heightens the importance of maintaining the structure of Social Security.”

However, the facts surrounding the airline’s pension default don’t really comport with the notion that large, underfunded, defined-benefit pensions are either desirable or stable. As an [editorial in the *Washington Post*](#) pointed out on Friday, companies that continue to use defined-benefit pension plans should be required to pay higher premiums to the Pension Benefit Guaranty Corp., the federal insurer of private pensions. Additionally, argued the *Post*, defined-benefit plans must be able to fund all pension promises within seven years.

Alex Tabarrok, associate professor of economics at George Mason University, noted the irony of reform opponents using the United Airlines default to defend Social Security, especially given that United will be switching to a defined-contribution 401(k) system in the future.

As he wrote on his website, [Marginal Revolution](#), “Now, let’s review. A large organization counts on its younger workers and continuing high revenues to fund the pensions and medical care of its retired workers but finds that rising health care costs, longer life-expectancy, and its own inability to control spending force it to cut pension benefits and switch to personal accounts. Kinda makes you go hmmm...doesn’t it?”

Traditional Social Security Is Poorly Suited to Modern Families

Writing this week in the *Washington Times*, Genevieve Wood of the Center for a Just Society [points out some of the often overlooked inequities](#) inherent to the Social Security system as it currently exists, particularly with regard to ways the system fails to distinguish between dual-earner families (and therefore two Social Security

contributors) and those who only have one working spouse, and therefore only one Social Security contributor. Her comments follow.

“For a system created to fight poverty and assist the poor and disenfranchised, America’s Social Security system is today one of the most unjust, unfair, unequal and discriminatory government programs in existence.

“Social Security is not just in trouble. Social Security is not just going bankrupt. Social Security is not just a poor return on investment. Today’s Social Security system is robbing, yes robbing, a father and mother of their ability to leave much of the money they put away for retirement to their children and grandchildren. That is unjust.

“Today’s Social Security system says to single people who die before they retire, not only will you never get a dime of the money you paid in, but none of your extended family will either. If you do make it to retirement, but upon your death fit the category of never-married, widowed or divorced, and you have no children (or if you do but they are older than 18), the current system says any monies still owed you cannot be passed on to other family members like brothers, sisters, nieces and nephews. That is discriminatory to those who die young and those who, for whatever reason, die single.

“Today’s Social Security system says if over your first nine years of marriage, you stayed at home and raised the children while your spouse furthered his career ... and then decided to marry the secretary and divorce you—*he* takes all the Social Security benefits, and you get none of the Social Security dollars that accrued during your nine-year marriage. If you aren’t married for a full 10 years, the first nine years and 11 months somehow don’t count when it comes to benefits. That is unfair.

“Today’s Social Security system rewards some married couples, but discriminates against others. Through a complicated formula only the government could cook up, couples where both husband and wife work, will receive a smaller benefit than another couple making the same income but with only one spouse working. That treats married couples unequally.

“Now there are those who claim such unequal treatment is somehow fair because it promotes the policy of one parent staying at home. Of course, it’s only fair to couples where one spouse has a job earning \$45,000 a year, but it’s not so fair to couples who can only get to \$45,000 if both mom and dad work. Mothers and fathers should have the right to decide how best to financially provide for their family without Uncle Sam penalizing them for it.

“Another anti-family aspect of today’s system is that it actually discourages marriage among those already retired. If a romance breaks out at Shady Pines Home for the Aged between Fred, a 75-year-old widower, and Ethel, a 73-year-old widow, and they choose to marry, guess what? Uncle Sam says you can’t both keep drawing your Social Security.

“Based on such a system, we shouldn’t be surprised if thousands of grandpas and grandmas are shacking up at nursing homes and assisted living communities across the country. If you’ll recall, for years we had a similar ‘marriage penalty’ embedded in our tax system that caused many married couples to pay higher taxes than if they had remained single, lived together and filed separately. Congress finally passed legislation

in 2001 that greatly reduced the marriage tax penalty, and they should do the same when reforming Social Security.

“Thankfully, Americans are often motivated by more than the bottom line—even their own bottom lines. In addition to getting a better return on their Social Security payments, whether through a Personal Retirement Account or some other measure, there is a moral case for reforming the current system. It’s about doing what is right, what is just, what is fair. It is time to talk about this debate in those terms.”

Publications

The Cato Project on Social Security Choice has released a new and improved version of its popular citizen’s guide to Social Security reform, “It’s Your Money.” The booklet shows why Social Security is in trouble and how a system of personal accounts can make retirement better and more secure. It goes beyond the “green-eyeshades” debate over insolvency dates, transition costs, rates of return, and unfunded liabilities to help lay readers understand what is really at stake—a better future for their children and grandchildren.

The booklet is now available for purchase at the Cato store (www.catostore.org), and will soon be available in an online version as well.

A new working paper from the National Bureau of Economic Research asks, “Has the Unified Budget Undermined the Federal Government Trust Funds?” The answer, according to economists John Shoven and Sita Nataraj, is yes.

According to the paper’s abstract, it “presents evidence that the trust fund build-up may not help future generations due to the adoption of the Unified Budget in 1970. The Unified Budget includes trust fund receipts as income and trust fund payments as expenditures. The empirical evidence suggests that attempts to balance the Unified Budget while the trust funds were generating surpluses has led to increased government spending and personal and corporation income tax cuts within the rest of the federal government. There is no evidence of increased government saving as a result of the trust fund accumulations. An alternate theory of increased national saving is also explored, where increased payroll taxes accompanied by decreased income taxes induces higher personal saving. This mechanism, suggested by Diamond, also does not appear to have significantly enhanced the wealth of future generations.”

NBER subscribers can download the paper [here](#).

Events

The Cato Institute will be hosting several events in the coming weeks on the topic of Social Security reform.

On Thursday, May 19, Michele Boldrin, John Rust, and Jagadeesh Gokhale will discuss Social Security’s potential to impact fundamental choices about family formation in a panel discussion entitled “Fertility and Social Security.”

Then, on Monday, May 23, there will be a forum on “Progressive Price Indexing for Social Security: What It Is, What It Isn’t,” featuring Robert Pozen, David John, Jason Furman, and Thomas Roe.

On Thursday, May 26, Cato will conduct a Hill Briefing on “Social Security for Deficit Hawks.” More information on this event will be released next week.

Finally, for readers in the San Francisco area, there will be a Cato City Seminar on Social Security and the Future of Limited Government at the Fairmont San Francisco on Friday, June 17.

For more information on these and other upcoming Cato Events, see our events page at www.cato.org/events.

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