

Social Security Choice

SOCIAL SECURITY THIS WEEK

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Pozen: Remarks on PRAs Were Misrepresented

Opponents of personal retirement accounts seized on remarks by Robert Pozen, the architect of progressive indexation, that they claim demonstrate Pozen's opposition to the president's plan for personal retirement accounts. The headline on the liberal website "Think Progress" read "Pozen Blasts Bush Privatization Plans." Senate Minority Leader Harry Reid said, "I am pleased that the inventor of the President's benefit cut proposal for Social Security has joined Democrats in calling on the President to reject private accounts. These accounts, with their deep benefit cuts and massive new debt, would weaken Social Security and leave American workers worse off."

However, Pozen responded to the uproar over his remarks by issuing a statement denying his opposition to PRAs. In testimony at the Treasury Department, it became clear that Pozen was suggesting that the president back off from personal accounts not because Pozen personally opposes them, but because Democratic lawmakers remain so united in opposition that they will thwart addressing the solvency issue, which to Pozen is more important than the ideological issue of ownership. According to a [Fox News report](#), Pozen said in a statement, "Given the lack of bipartisan support for carve-out personal accounts, the president should not insist on carve-out accounts if the Democrats support an overall legislative package for Social Security reform that is otherwise satisfactory to him."

[According to the New York Times](#), "unlike Democratic lawmakers who oppose as a matter of principle including investment accounts as part of Social Security, Mr. Pozen, himself a Democrat, says that some form of accounts could be useful."

Indeed, the *Times's* assessment of Pozen's position is consistent with his previous comments on personal accounts. In a [recent interview](#), Pozen said:

"Personal accounts are the dessert. Those are the things that people believe are the political sweeteners and that's where all the focus has been. And that's where a lot of the ideological conflict is. If we concentrated on the spinach, the main meal, then we'd look at solvency. We'd get that nailed down and then we could move on to what should be the appropriate sweeteners. Personal accounts is a possible sweetener, but I think the

American people knows in its heart that first we have to address solvency. First we have to address the spinach. Then we can go on to the sweeteners.

Rep. Wexler's Tax Hike Proposal Falls Flat

Rep. Robert Wexler (D-FL) courageously broke ranks with his party this week by offering a legislative alternative to the president's proposal for Social Security reform. Called the "Social Security Forever Act of 2005," Wexler's bill would subject all earnings over the current \$90,000 cap to a 6 percent tax, which a *Wall Street Journal* editorial identified as "one of the largest marginal-rate tax increases in decades." The *New York Times* editorial page—as well as its news bureau—has remained silent on Wexler's bill.

According to *The Hill*, Wexler claims that party leaders are "privately encouraging him to move forward," just as many congressional aides have roundly derided the move as a political blunder. An aide for Minority Whip Steny Hoyer was quick to distance Hoyer from Wexler, asserting that "anyone insinuating that Mr. Hoyer is endorsing or encouraging this proposal and its timing is dead flat wrong and fishing for a story that isn't true."

Unfortunately, the financial implications of such a large hike in the payroll tax would be profound—separate studies by economists Martin Feldstein and Nobel laureate Ed Prescott have demonstrated that higher marginal tax rates tend to negatively affect the labor market, productivity, and reported income. But apart from those problems, simply raising taxes to add to the "trust fund" won't prevent either this Congress or future Congresses from using the annual surplus to fund programs totally unrelated to the operation of Social Security.

As Michael Tanner argued in the op-ed "[The Point is Ownership](#)," the only way to prevent Congress from misusing Social Security funds is to give Americans ownership and control over their Social Security dollars through a system of individually owned retirement accounts; without the guarantees of ownership, promises of reform ring as hollow as the unfunded promises of Social Security.

Tanner to Ways and Means: PRAs Protect Vulnerable Populations

In testimony before the House Ways and Means Committee this week, Mike Tanner, director of Cato's Project on Social Security Choice, told the committee that "by making personal accounts part of any Social Security reform, we can give low-income workers a chance to build a nest egg of real inheritable wealth. In combination with an enhanced safety net, we can provide vulnerable workers with a new and better Social Security system."

Noting that Social Security performs as both a retirement program and an anti-poverty program, Tanner argued that it performs neither function particularly well. He continued:

"Since Social Security currently cannot pay promised benefits, benefits will eventually have to be reduced by roughly 26 percent, a reduction that will fall heaviest on those who can least afford it. On the other hand, reform, properly structured, can not

only protect the poor and vulnerable from these otherwise inevitable benefit cuts, but can actually produce an improved Social Security system that will leave them better off. We can give low income workers a chance to build real inheritable wealth. We can give them an ownership stake in the American economy. And, while maintaining a safety net, we can give them a chance to earn a higher rate of return, leading to higher retirement benefits that would lift millions of seniors out of poverty.”

To see the full text of Tanner’s testimony, click [here](#).

Cato Scholar: Entitlement to Social Security Is an Illusion

In a [recent commentary](#), Cato policy analyst Will Wilkinson examined the structure of Social Security and found that the commonly held notion of the system—that it is a contractual insurance policy to which taxpayers are entitled—is a deliberate ruse. His commentary follows.

“If you think that paying the Social Security tax legally entitles you to benefits, you’re wrong. Social Security is a payroll tax on the one hand and a set of transfers from the government on the other. The two are connected in the way David Blaine levitates: He doesn’t; they aren’t; it’s illusion.

“Despite the fact that your payroll taxes are called ‘federal insurance contributions,’ they are nothing like insurance policy premiums because there is no policy, no contract, and no legal claim to benefits. Your payroll taxes are nothing special, just taxes. They’re spent right away on checks to current retirees and items in the general budget, like the war in Iraq and subsidies for mohair producers.

“The money that comes out of your paycheck buys you nothing, not even a right to retirement benefits. That’s the upshot of the 1960 *Flemming v. Nestor* Supreme Court decision. Whether you’re going to receive a Social Security check from the government at all depends entirely on the good grace of folks like Tom Delay and Ted Kennedy. Social Security provides no ‘guarantees.’ Every serious plan to make Social Security solvent involves higher taxes, smaller benefits, or both. You may feel that you’ve earned a right to Social Security benefits by paying all those taxes all those years, but all you’ve really got is a feeling, because the right, legally speaking, ain’t there. Social Security is not secure.

“Personal retirement accounts, however, would give each worker genuine property rights to his or her retirement savings. The money that goes into a PRA goes straight from your paycheck into an account that you own. It’s not a promise; it’s property. Instead of paying taxes for missiles and mohair, you get a tax cut that allows you to save and invest for your own retirement. And because what you save is yours by right, you can, unlike Social Security, pass it on to your loved ones when you die. With PRAs, you literally own the source of your retirement security, and it cannot be held hostage, whittled down, or bargained away by future Congresses.

“The fact that PRAs offer a real, legally-binding right, while the status quo offers only cheap-talk, is a thorn in the side of status quo-ists like Paul Krugman. In a recent debate, the Cato Institute’s Michael Tanner pointed out to Krugman that Social Security offers no guarantee and turns retirees into supplicants hostage to the grace of Congress.

In response, Krugman called the fact that retirees have no legal right to their retirement benefits a 'fantasy problem.' Why? Because 'the government can take lots of things away if it chooses to. Private property is a social institution, not a physical fact.'

"What Krugman is saying is that there is nothing to stop the government from violating its citizen's rights, and so genuine, legally-binding property rights are only a paper assurance that adds nothing to retirement security. 'Yes, the government might end up failing to pay the current schedule of benefits,' Krugman admits. But 'the government might also levy prohibitive taxes, it might seize your property.' Krugman goes on to argue the real bulwark against government depredation is public opinion and political pressure. Because Social Security is so wildly popular with seniors, of which there are many, there's little chance benefits will be 'gratuitously reduced' by election-seeking politicians.

"But Social Security is so popular largely because citizens think they have real legal rights to their benefits because they paid taxes all those years. And they think it because the government has manipulated us into thinking it.

"Political manipulation: that's the function of a payroll tax dressed up as 'insurance contributions' and the accounting mirage that is the 'Old-Age Insurance trust fund.' Roosevelt insisted that Social Security be funded through a special payroll tax rather than general tax revenue in order to create the perception of moral, legal, and political entitlement to benefits. Americans believe in private property and the sanctity of contracts. So Roosevelt, without scruple, told Americans that their payroll tax 'premium' was 'buying' an 'insurance policy' with the government. He told Congress that the 'old-age insurance system' has created 'individual accounts' for millions of workers who may be 'likened to the policy holders of a private insurance company.'

"'With those taxes in there,' Roosevelt once said in a candid moment, 'no damn politician can ever scrap my social security program.'

"Of course, there are no 'policies,' 'individual accounts,' 'premiums,' or 'insurance,' and there never were. Social Security is a regressive tax and a stream of government checks. The rest is an elaborate illusion meant to prejudice the democratic process and insulate Social Security against reform. The architects of Social Security 'sought to foreclose the options of future generations' and had 'designed social security to be uncontrollable,' observed eminent Social Security scholar Martha Derthick. Social Security became the 'third rail' of American politics only by grafting on to deep American convictions about property, contract, and insurance.

"It is therefore specious in the extreme to argue, as Krugman does, that legally-binding property rights over personally owned retirement accounts offers nothing in security that the status quo does not already have.

"The political vitality of Social Security-as-we-know-it was designed to be parasitic on the American commitment to property and contract. But parasites cannot be more secure than the host. If Congress fears to trespass on illusory property, it will not be bolder when encountering a real legal fence. Personal accounts—real ownership, real rights—offers in reality what the status quo offers only in appearance. The shadow, as Plato would remind us, is not more solid than the form.

“Americans deserve real ownership, real property, and real retirement security. Unlike the slowly eroding status quo, PRAs offer Americans the real thing.”

Roundup of Alternatives to Personal Retirement Accounts

Last week, former president Bill Clinton told ABC’s *Good Morning America* in an exchange that never made it to broadcast, “I think Democrats should say what they are for on Social Security in the next couple weeks.... Democrats should have a plan and they should talk to the president and Congressional Republicans about it.” So far though, the few ideas from those insistent on maintaining Social Security’s current structure suggest that perhaps silence from opponents of reform is their best tactic—the less they mention alternatives to personal accounts, the better.

Robert Wexler

The bill introduced by Robert Wexler this week relies solely on tax hikes to shore up Social Security’s finances. Wexler proposed a 6 percent tax on all income over the current payroll tax cap of \$90,000.

As described above, Wexler’s plan would not achieve the sort of permanent solvency that could be provided by personal accounts, and what little it could achieve would be offset by the effects of increased marginal tax rates on the economy overall.

Additionally, and perhaps most troublingly, tax hikes without corresponding benefit increases would destroy any remaining link between contributions and benefits. This, in turn, makes explicit the fact that Social Security operates not as an insurance program, but as a safety-net program that hides its true nature by providing universal benefits even to those who do not need them.

If Wexler is of the opinion that Social Security should be preserved not as social insurance but as a transfer program to guarantee against poverty, as his bill suggests, he should have little ideological opposition to a system of personal accounts that includes a guaranteed minimum pension.

Martin Sabo

In February, Rep. Martin Sabo (D-MN) introduced legislation that would achieve solvency by raising the interest rates paid on the trust fund. Sabo’s bill says the trust fund can get a better return. Not by investing in stocks or corporate bonds, but simply by declaring that the fund will get a better return. His bill would mandate that trust fund bonds carry “an effective real annual rate of interest at 6 percent.” Hence, with a stroke of a pen, the Social Security problem has been solved.

This legislation is manifestly silly as a tool to keep the Social Security system solvent. But examining it makes clearer that the trust fund itself is not an asset. Both the principal and the interest in the fund must be repaid by the taxpayer. The underlying purpose of Sabo’s bill is simply to shift Social Security toward general revenue financing. Since trust fund bonds are paid off using general revenue, raising their interest rate will funnel trillions of dollars in non-payroll tax funds into the system without making clear to the public exactly what is going on. Social Security reform commissions and experts from all sides of the debate have rejected general revenue financing even when done openly, and it is hard to see that the covert diversion of general funds will go unnoticed

or unopposed. As far as Sabo is concerned, protecting Social Security is worth deceiving the American public through accounting that is even less transparent than the current financing structure.

Mike Tanner, director of Cato's Project on Social Security Choice, said, "Why not take it a step further and mandate 200% interest? We could fund the entire government that way."

AARP

The seniors organization has endorsed three means of preserving Social Security in its current structure, none of which is particularly attractive: raising the payroll tax cap from \$90,000 to \$140,000; government investment of a portion of the Social Security surplus; and forcing all state and local employees into the Social Security system.

Forcing state and local workers out of their own pension programs and into Social Security frankly borders on immorality. Many of the systems set up by states and localities are far superior to Social Security—they offer better retirement, disability, and survivor benefits at a much lower cost. Forcing teachers, firemen, and police officers out of their efficient and low-cost employment specific programs, for example, just to add a few years to the solvency of Social Security in unconscionable and will doubtless meet with stiff opposition from those groups' respective unions.

Allowing the government to invest a portion of the surplus in private enterprises is a recipe for disaster. As Mike Tanner wrote in the Cato Briefing Paper "[The Perils of Government Investing](#)," allowing the government to invest the trust fund surplus "could potentially make the federal government the largest shareholder in American corporations, raising the possibility of government control of American business. In addition, there are serious questions about what types of investment the government would make. Political considerations and 'social investing' are likely to influence the government's investment decisions, allowing the government to manipulate economic markets."

Finally, raising the payroll tax cap would have some of the same disastrous effects on the economy as the Wexler plan, and it would similarly add only a number of years to the solvency of the program. According to a paper by Harvard economist Martin Feldstein, raising the cap to a more modest \$120,000 could result in a loss of 7 percent in reported income as people shift their work habits and income streams to avoid taxation. This deadweight loss would result not just in a decrease in payroll taxes collected, but also a decrease in income taxes collected.

Supporters of Repealing the Bush Tax Cuts

Several Democratic lawmakers have floated the idea of closing up the funding gap by repealing a part of the Bush tax cuts—or in other words, raising income taxes. As Heritage's David John pointed out in a May 9 op-ed in *Investor's Business Daily* by Jed Graham, "For every complex problem there is a solution that is simple, easy to understand, and completely wrong."

Because Social Security is supposed to be funded by a dedicated income stream—the payroll tax plus taxes on benefits—raising income taxes can't help the condition of Social Security's finances. The money collected by repealing the cuts would be general

revenue, not Social Security revenue. In the short term, some lawmakers argue that the additional revenue could be used to pay off the Social Security Treasury bonds as they come due. (This, of course, should make clear to defenders of the trust fund that it is not an asset in and of itself—as supporters of saving Social Security through raising taxes tacitly acknowledge, the money needed to keep Social Security afloat between 2017 and 2041 will have to come from *somewhere*.)

Beyond 2041, it is unclear how raising income taxes will help keep Social Security solvent, unless the proposal is to make Social Security a program that is funded from general revenues and not a dedicated tax—in that case, maintaining Social Security’s structure as a program that provides benefits even to those without a demonstrated need will become a very tough sell indeed.

This Week in the Polls

A poll released by Angus Reid Consultants revealed that support for personal accounts in May stands at 47 percent, up from 44 percent in March. Opposition to personal accounts has remained constant at 40 percent during that time. The findings follow a recent trend in polling that suggests that support for personal accounts in general is higher when the idea stands on its own, apart from association with the Bush administration’s efforts.

Also this week, a poll [reported in the *Las Vegas Sun*](#) found that 50 percent of Nevadans favor the Bush plan, compared to 42 percent in opposition. The poll revealed that support or opposition largely fell along party and age lines with 54 percent of people under 65 and 69 percent of registered Republicans supporting the president.

Events

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

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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