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Tanner: What's So Surprising about Bush's Social Security Plans?

The Kerry campaign recently released a disingenuous ad accusing George Bush of planning a Social Security "January Surprise". It's hardly a surprise though, writes Cato's Mike Tanner: the president has been widely announcing his intentions in speeches across the country over the entire campaign season. In a recent op-ed in the *Austin American Statesman*, Mike Tanner asserts that the president has been straightforward, openly advocating personal retirement accounts for months, noting that Kerry is the candidate who has yet to announce his plan to secure Social Security. Tanner's commentary follows.

"What would a political campaign be without a Democratic attack on Republican plans to destroy, dismantle or privatize Social Security?

"It was only a matter of time until John Kerry trotted out this well honed campaign tactic. Now, Kerry has attacked President Bush for planning 'a January surprise' that would 'privatize' the government-run retirement program.

"Setting aside semantic debates about the term 'privatize,' Bush's plan is hardly a surprise. The president has repeatedly said that he would allow younger workers to privately invest at least a portion of their Social Security taxes through individual accounts.

"You can agree or disagree with that idea, but the president has not tried to hide where he stands.

"On the other hand, Kerry has given us few clues as to how he would solve Social Security's looming financial crisis.

"Social Security will begin to run a deficit—spending more money on benefits than it takes in through taxes—in less than 15 years, by 2018 according to the last report of Social Security's trustees.

"The so-called Social Security Trust Fund, which is supposed to help pay benefits until 2042, in reality contains only government bonds, essentially an IOU. While few doubt that those benefits will ultimately be paid, the federal government will still have to find the money to pay them. Ultimately, Social Security's unfunded liabilities exceed $26 trillion. That's real money, even by Washington terms.

"And what would John Kerry do about this? Mostly he tells us what he would not do.

"'I will not privatize Social Security,' he tells audiences. 'I will not cut benefits.'

"Pressed further, he says he might offer unspecified 'tweaks' to help the program. And, during the final presidential debate he indicated he might consider appointing a commission to study the matter.

"As former President Bill Clinton pointed out, there are really only three options for Social Security reform: raise taxes, cut benefits or invest privately. Since Kerry rules out private investment or benefit cuts, he could legitimately be accused of implicitly endorsing tax increases.

"And mighty big tax increases they would have to be, a 50 percent increase in the payroll tax or the equivalent. It would be a tax increase far higher than what Kerry would 'save' by rolling back parts of Bush's tax cuts — even if he hadn't already promised to use those savings to fund other government spending. And, contrary to Kerry's promises, it is a tax increase that would fall on workers earning less than $200,000 per year.

"Not that financing is the only problem with Social Security. The program already provides today's workers with a low, below-market return on their taxes.

"The program unfairly penalizes African Americans, working women and others. Workers don't own their money or have any guaranteed right to their benefits. In short, it is a program crying out for reform.

"But Kerry continues to duck the issue.

"That isn't good enough. No one should be running for president if he can't stand up and tell the American people what he plans to do about the looming Social Security crisis.

"If Kerry plans to raise taxes to prop up Social Security, he should tell us. If he has another idea, he should share it with us.

"If he believes that the current program, with all its problems, is the best we can do, he should say so.

"But fear mongering is not a Social Security plan."

William G. Shipman: Benefits of Reform Far Outweigh Costs

In a commentary this week in *Investor's Business Daily*, Social Security reform advocate and a co-chairman of Cato's Project on Social Security Choice Bill Shipman expanded on President Bush's assertion that the cost of doing nothing to solve Social Security's financial problems would be far greater than the cost of reforming the system to include private accounts. An excerpt of Shipman's op-ed follows.

"The problem with [private accounts], many argue, is that the transition to the new system would be too expensive.

"Under present law, projected payroll taxes will not be enough to pay all promised benefits; redirecting some of that tax money to personal accounts would incur a further burden. Some people would have to pay twice, once for their own personal account and then for those already receiving Social Security benefits. This double cost may be in the trillions of dollars and our nation, at least at this stage, just can't afford it.

"This argument appears persuasive, and for a couple of reasons.

"There is some truth to it. But more important, it is not complete. It does not consider the costs of the existing system should it go without reform. Recognizing these costs sheds an entirely different light on the benefits of reform.

"To compare the two systems' costs, let's first assume that Social Security is not reformed. According to the program's trustees, this would lead to payroll taxes being insufficient to pay all benefits by about 2018.

"Let's further assume that the government at that time borrows the difference so that all benefits are honored. Such borrowing would continue through 2078 and then well beyond because the demographic trends that cause the imbalance are well established and not subject to meaningful change.

"Of course, the government would have to borrow even more than the shortfall in taxes in order to pay principal and interest when due on the funds previously borrowed. The trustees estimate that total borrowing only to 2078 would be about $4.5 trillion in present value terms.

"Another way of presenting this is each American family would have to give the government about $43,000 today plus pay payroll taxes stipulated in present law in order to afford promised benefits.

"Now let's assume we reform the system as broadly outlined by Bush. What happens.

"First of all, not everybody is going to jump on the president's idea, and for good reason. A 64-year-old wouldn't want to budge from the current Social Security program because he wouldn't have sufficient working time left to save and invest enough to replace what he would otherwise receive from the government program.

"Conversely, a 21-year-old would opt for the personal account because he does have time to accumulate enough wealth on which to retire with benefits that most likely would be far greater than those from Social Security.

"If a 21-year-old would choose the new system and a 64-year-old would not, then there must be an age between 21 and 64 when one is indifferent—that is, one would get as much from one system as the other.

"Let's assume it's 35. All workers older than 35 would stay with Social Security, pay the full payroll tax and receive the stated benefit. All younger than 35 would choose the market-based alternative, save and invest part of their payroll tax for their retirement and continue to pay the remainder of the payroll tax to the government to help provide for those who stay with Social Security. The government is largely off the hook for them and fully off the hook for all new, younger workers who enter the labor force.

"The government's liability, therefore, is now capped at the benefits payable to those over 35 and the much lower accrued benefits of those under 35. Starting almost immediately, the total number of workers and retirees in the older group shrinks because of death and the fact that no one enters the group. When the last person dies, the government's benefit payments drop to zero.

"The government's ongoing liability for the younger group fazes out as well because more and more people of this expanding group provide for themselves exclusively through their personal accounts.

"The ultimate steady state, when each individual provides for himself, takes decades. In the interim, however, financing is required just as if there were no reform.

"But there's one important difference: This borrowing is not endless; it's temporary."

Shipman concludes: "Under all reasonable assumptions, a market-based Social Security system will, over the long run, always be less costly than remaining with the present structure. And long-term viability must be one of the fundamental goals of any Social Security reform."

Gokhale and Smetters: Kerry's "Pay-As-You-Go" Rules Won't Work for Social Security

Writing in the *Wall Street Journal* last week, Cato senior fellow Jagadeesh Gokhale and Wharton School professor Kent Smetters point out that the pay-as-you-go rules championed by John Kerry in last week's final presidential debate don't make sense when applied to the financing of Social Security. Not only is pay-as-you-go not preferable to a prefunded Social Security system, but PAYGO rules actually make the problems worse, they write. Their commentary follows.

"Mercifully, the words 'lock box' weren't uttered once. Nonetheless, the last presidential debate produced the starkest contrast yet in the candidates' approaches toward entitlement reform. President Bush wants to introduce personal Social Security accounts for young workers and future generations. This will sequester their payroll taxes from being diverted by the government to fund other programs. Sen. Kerry, however, rejects that approach, rejects benefit cuts, and provides no concrete reform plan except a vague promise of making changes along the way as needed. To us, that suggests future tax hikes.

"During the debate, Sen. Kerry also said that he would adopt a 'pay-as-you-go' approach to ensuring financial solvency to Social Security. President Bush's response, though apt, needs amplification.

"We think it's high time the public was clearly informed about when pay-as-you-go is effective and when it is dangerous. It's effective in imposing fiscal discipline when we are concerned with surging discretionary spending. Such spending is annually appropriated by Congress and used to finance public goods such as defense, roads and highways, judicial services, and homeland security—items that potentially benefit future generations. Under pay-as-you-go rules discretionary spending can be increased only if Congress is willing to finance it 100% out of other spending cuts and tax increases. The political undesirability of both financing methods serves to check both higher deficits and growth in the size of the government.

"On the other hand, the pay-as-you-go approach has proved ineffective in imposing fiscal discipline in our entitlement programs. Pay-as-you-go in this context usually implies benefit increases—for which retirees obviously don't pay—and tax increases for workers and future generations. The taxpayers' higher future benefits never make up for their earlier payroll tax hikes in present value—and future benefits remain subject to changes. Consequently, today's retirees (who vote in larger numbers) receive windfalls, but workers and future generations lose out.

"Pay-as-you-go, therefore, is precisely the approach that has created a financial mess in Social Security and Medicare. Our future benefit commitments now far exceed our ability to pay. The financial imbalance is now estimated by Social Security's independent actuary to equal $10.4 trillion. For Medicare, the overall shortfall is even larger—$62 trillion. Using the official numbers, we estimate that rejecting an attempt to control the growth rate of costs implies an immediate and permanent tax hike of 17.4 percentage points. That would more than double the current payroll tax rate of 15.3%. Inaction over another four years will increase the required hike to 19.7 percentage points. A recent study by the latest Nobel laureate for economics, Ed Prescott, points out that higher tax rates will slow economic growth.

"As the aphorism goes: When you're in a hole, stop digging. A promise of inaction or, at best, of continuing to use the pay-as-you-go approach, is not a solution to our entitlement programs' financial travails. It is an invitation to continue digging deeper."

Washington Times*: Kerry Resorts to Scare Tactics on Social Security*

An editorial in the *Wall Street Journal* this week scrutinizes John Kerry's demagoguery of Social Security. A similar editorial ran in the *Washington Times*. Scare tactics directed at older voters were somewhat successful for Gore among older voters in 2000, and Kerry strategists want try to do the same this year, the editorial contends. According to the editorials, President Bush is proposing a fiscally responsible, workable plan while Kerry manipulates the facts in order to discredit personal savings accounts. An excerpt of the *Journal*'s commentary follows.

"You can tell it's getting close to Election Day, because the senior scare campaign is back. John Kerry got things going on the weekend with an accusation that President Bush is planning a 'January surprise' to 'privatize' Social Security. And, right on time, his campaign is rolling out an ad that claims Mr. Bush 'has a plan that cuts Social Security benefits by 30 to 45%.'

"We are supposed to believe that the peg for this accusation is a story in Sunday's *New York Times Magazine*, by Bush antagonist Ron Suskind, that the President told a group of donors he was going to push hard for tort reform, tax reform and private Social Security accounts in January if he wins re-election. Please. If this is a scoop, journalistic standards are slipping more than we thought.

"The 'surprise' that Mr. Bush wants to reform Social Security was merely disclosed last month before, oh, the 28 million people and thousands of journalists who watched his Republican Convention speech.

"'We will always keep the promise of Social Security for our older workers,' Mr. Bush said in New York. 'With the huge Baby Boom generation approaching retirement, many of our children and grandchildren understandably worry whether Social Security will be there when they need it. We must strengthen Social Security by allowing younger workers to save some of their taxes in a personal account—a nest egg you can call your own, and government can never take away.' If the Bush donors thought they were being let in on some top secret agenda, they should demand their money back.

"No, what's really going on here is another late-innings attempt to scare seniors into believing that Mr. Bush wants to take their benefits away. Trailing late in the 2000 race, Al Gore tried this and it almost won him the White House. Mr. Gore narrowly lost in Pennsylvania among voters younger than age 65, according to the exit polls, but he won 60% to 38% among seniors. Now Bob Shrum, who advised Mr. Gore, is attempting the same gambit with his new boss, John Kerry.

"We hope the Bush campaign does a better job of fighting back this year than it did in 2000, when it assumed it could coast to victory. This time the attacks are starting earlier, and Mr. Bush is going to have to rebut these accusations as the demagoguery they clearly are.

"Start with the political scare word, 'privatization.' This accusation works with some voters because many Americans mistakenly assume that their payroll deductions are currently going into a government account with their name on it that will then be paid out when they retire. Privatization conjures up a vision that they will have to provide for their own retirement with no government safety net whatsoever.

“Sorry to break it to these trusting souls, but there are no Social Security accounts. Today’s payroll taxes are spent by today’s politicians. And in today’s system, future benefits depend on politicians elected years from now keeping to the spirit of vague promises made by today’s politicians. That’s not the kind of guarantee we find comforting. Mr. Bush is talking about giving workers the kind of personal accounts, with an actual property right, that many thought they had all along, and filling them with real assets, not mere promises.

“Social Security would still be a government program, but one with a choice of whether to stick with the negative real returns currently offered, or obtain positive growth available from a diversified portfolio of assets. Even the safety net part of Social Security would be made stronger and more reliable by putting government finances on a more sustainable footing. Far from cutting benefits, this is the only way to preserve them, short of raising taxes to a level that would destroy the economy.”

Thune, Daschle Show Stark Difference on Social Security

A recent Associated Press recap of the debate between Senate Minorty Leader Tom Daschle and Republican challenger John Thune highlighted the difference between the two candidates on Social Security reform. According to the article, which appeared in the *Rapid City Journal* and other news outlets, Thune advocates introducing a private accounts component to Social Security while Daschle wants to simply create a “lock box” where Social Security taxes will be kept. Given that a “lock box” plan will be of limited value once benefit payments exceed intake in 2018, Thune calls Daschle’s proposal a “do nothing” plan. An excerpt of the article follows.

“Senate Minority Leader Tom Daschle and former Republican Rep. John Thune clashed sharply in a televised debate Tuesday night on proposals for fixing Social Security and making health care more affordable.

“In a debate sponsored by KDLT-TV of Sioux Falls and The Associated Press, the candidates were asked what they would do to preserve Social Security, which may be unable to pay full benefits after 2042.

“Thune said he would support allowing younger workers the option of taking some of their Social Security money and investing it in personal retirement accounts regulated by the government. He said that would help extend the life of the Social Security system while safeguarding the benefits expected by older people.

“‘We’ve got to do something because the cost of doing nothing is horrible,’ said Thune, who is trying to unseat Daschle.

"But Daschle, who is seeking a fourth Senate term, said Thune's plan would lead to a 40 percent cut in benefits for those who continued in the traditional Social Security system.

"'John's proposal is virtually the elimination of the Social Security system as we know it today,' Daschle said.

"Daschle said the Bush administration has tapped Social Security funds for other purposes, a practice he said jeopardizes the retirement system. Social Security should remain financially healthy for a long time if its funds are protected, he said.

"'We've got to put it in a lock box. We've got to make sure we've got that money available,' Daschle said.

"Thune said his proposal would not threaten Social Security or cut people's benefits. 'Social Security is headed for bankruptcy. Tom's solution is to do nothing.'"

Ben Bova: Retirement Saving Should Be a Personal Matter

Ben Bova writes in the *Naples Daily News* that the private sector can offer significantly higher payouts than the current Social Security system. He supports Bush's proposal to privatize Social Security, arguing that Americans are able to handle their own finances more efficiently than government. In the current system, the payroll tax surplus is not saved for the retirement of today's taxpayers, but is used for programs that promise the most votes, Bova explains. Individuals, on the other hand, have incentives to make decisions that increase their wealth and not the probability of re-election. Bova's commentary follows.

"Privatization. The idea of allowing private companies to do tasks that are now done by government.

"There's a real difference between President Bush and Sen. John Kerry over the idea of allowing a limited amount of privatization of Social Security. Bush thinks individuals should be allowed to invest some of their Social Security payments in the private sector of the economy: stocks, bonds, annuities, etc. Kerry thinks this is taking unnecessary risks with individuals' Social Security money.

"So the question about Social Security is: Which can provide you with a better deal, the government or private investments?

"From its inception in the Depression-ridden days of the 1930s, Social Security has been totally a government-operated system. You are required to pay into the system, through your taxes. The government pays you back when you retire.

"Sounds fine, except that the government doesn't just hold your money for you. The government spends it. And keeps on adding more and more ways to spend it.

“As more than one observer has commented, our Social Security system is like a pyramid scheme. The money you pay in is not held for you; it goes to pay for other people’s pensions and other allowances, such as college tuition for orphans, regardless of their financial need. When you retire, your benefits will be paid by the younger generation who are still paying their Social Security taxes.

“This is a classic pyramid scheme, which is outlawed in the private marketplace, but perfectly legal for the government to operate. And it works fine, until you have more people demanding their payoff than you have people paying into the system. Which is exactly where Social Security will be in a few years, when the baby boom generation starts retiring.

“If people are allowed to invest part of their Social Security funds in private investments, they stand to get much larger payoffs than the government can provide. There are risks, of course. The stock market doesn’t always go up; it can drop, sometimes steeply. But if you look at the performance of private investments over the span of an individual’s working career—40 years or so—you can see that private investments have earned far more money than your Social Security account has garnered.

“For example, if I had been able to invest half the money I was required to put into Social Security in private investments, over the course of my working career I would have earned 10 times the amount the government now doles out to me.

“(Of course, writers don’t retire. But that’s another story.)

“I favor some degree of privatization of Social Security. With the proper controls in place, individuals should be able to put their money into low-risk investments and earn much more than the all-government-controlled system can pay out.

“The cynic in me says that politicians who oppose privatization do so because they don’t want to see the control of even a part of that huge Social Security bankroll slip out of their hands. To me, the real risk is not investing in private markets; the real risk is allowing the politicians to continue raiding Social Security for their own political gain.

“And make no mistake about it, when politicians make decisions about Social Security (or anything else) they base their decisions on *political* reasons, first and foremost. The primary question a politician asks himself is: How will this affect my chances in the next election?

“Private citizens and business leaders base their decisions on *economic* grounds: How can I make the most money for myself or my company?

“Thus we see the Social Security fund constantly being usurped for purposes that have nothing to do with individuals’ retirement benefits. New categories of beneficiaries are added, because the politicians believe this will gain them more votes. It’s not like a savings account in a bank, where you can keep track of how much you’ve paid in and how much interest you’ll earn. You pay what the government *requires* you to pay, and you receive—when you retire—what the government decides you should receive. You have no control over either the pay-in or the eventual pay-out.

"Do individual citizens have the intelligence to invest a part of their Social Security taxes wisely? Would they be able to build up a larger nest egg for themselves through private investment, or would they blow the money on fly-by-night schemes, or lose everything in a massive crash of the stock market?

"I believe the average citizen is smart enough to manage his or her money wisely, especially if there are stringent safeguards put on the types of investments that would be allowed. No gold mine stocks or high-flying IPOs; investments should be limited to proven annuities, high-rated bonds, and top-level blue chip stocks—investment opportunities that have proven their soundness and stability.

"Kerry thinks this is too risky. He apparently believes that the average American isn't wise enough to manage his or her own money, but the government is. President Bush wants to allow some degree of privatization; he apparently believes you can handle your money better than the government can.

"I agree with President Bush."

Publications

The Center for Retirement Research at Boston College has just released a new issue in brief entitled "Will Health Care Costs Erode Retirement Security?" by Richard W. Johnson and Rudolph G. Penner. The paper discusses the financial strains put on retirement savings as healthcare costs continue to rise, adding that the skyrocketing reforms are likely to cause problems regardless of reforms made to Social Security and Medicare.

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