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SOCIAL SECURITY THIS WEEK

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Another Poll Shows Strong Support for Individual Accounts

A post-election survey by McLaughlin & Associates conducted for the United Seniors Association is the latest public opinion poll to show strong support for allowing younger workers to privately invest a portion of their Social Security taxes through individual accounts. According to the survey of 1,000 actual voters on November 2, 56 percent of voters supported individual account proposals as long as current retirees and near retirees received all promised benefits. Only 32 percent were opposed. Support for individual accounts cut across demographic and political lines, with majorities of men (56%), women (57%), young people (66%), African-Americans (62%), Hispanics (65%), Catholics (63%), and Evangelicals (62%) all backing the concept by substantial margins. Majorities of conservatives (71%) and moderates (51%) supported individual accounts, but so did 41% of liberals. Bush voters overwhelmingly backed individual accounts (69%), but so did 44% of Kerry voters.

Obama: We Should Be "Open-minded" on Social Security Reform

Two guests on NBC News' "Meet the Press" this weekend spoke about the future of Social Security reform. The Democratic Senator-elect from Illinois, Barack Obama, gave proponents of PRAs cause for optimism when host Tim Russert asked if common ground could be found between Democrats and Republicans on Social Security. Obama answered:

> I think that when it comes to Social Security, all of us want to make sure that our senior citizens can retire with dignity and respect. And everybody has to be open-minded in thinking how do we firm up a system that, in fact, is going to be in difficulty in the coming years. So I absolutely think that it's possible for us to find common ground.

Also appearing on the show was Karl Rove, who underscored the fact that the costs of not reforming Social Security are far greater than the transitional costs of private accounts. The exchange between Russert and Karl Rove on Social Security follows:

MR. RUSSERT: In terms of Social Security reform, there had been a commission headed by Daniel Patrick Moynihan that talked about allowing Americans to take part of moneys that they pay in payroll tax and put it into private accounts. That's when we had a $2 trillion surplus. In light of a $422 billion deficit, can we, in fact, reform Social Security with private accounts when the transition costs are estimated to be $2 trillion?

MR. ROVE: Well, first of all, there's one cost that hasn't changed and that is the cost of doing nothing. The system is going to be fine. Social Security is fine for those at or near retirement today. For those receiving their checks today, don't worry. It's going to be there for you. For those that are nearing their retirement years, don't worry, it's going to be there for you. But for your kids—for your boy and my boy, and for their children, for our kids and grandkids, it's a real big question as to whether or not the system's going to be there.

The number that has not changed is the number of the unfunded liabilities that we're going to see about mid-century if we don't do anything. And that's about $13 trillion and growing. What we need to do is to deal with this problem before it becomes too large that it swamps our children and our grandchildren, and the president's committed to doing something. The commission pointed out several avenues. There are other bills up on the Hill that show other means to get there. But we need to do something and start doing it now before the costs swamp our children and grandchildren in the years ahead.

Gokhale on Social Security Reform and the Bond Market

Cato senior fellow Jagadeesh Gokhale wrote a commentary this week discussing the possible effects of reforming Social Security to a system of private accounts, focusing specifically on reform's effect on the bond market. Gokhale concludes that a system of PRAs—if carefully and thoughtfully structured—could boost saving and improve conditions for capital markets. However, he warns, the wrong reforms could wreak financial havoc. The text of Gokhale's commentary follows.

"With the re-election of President Bush, everyone from Wall Street to Main Street is now wondering about the financial impact of a now more likely Social Security personal accounts reform. Allowing workers to deposit part of their payroll taxes into personal accounts would siphon off revenues currently used to pay retiree benefits—payments that consequently would require larger federal borrowing. In addition, the government may issue marketable 'recognition bonds' to personal account participants reflecting benefits accrued from their earlier payroll taxes. By how much will federal debt held by the public increase and how will financial markets be affected constitute today's $10 trillion questions.

"The prospect of a massive increase in U.S. federal debt appears scary. Closer reflection, however, reveals that the concerns about a negative impact are overblown. Suppose that half of total payroll tax revenues—$300 billion in 2005—are redirected into private capital markets. The government would then have to borrow only an additional $212 billion to continue paying current retirees their benefits. This is because payroll taxes are projected to exceed Social Security outlays in 2005 by $88 billion—an amount that the government won't have to borrow to meet benefit commitments. Thus, more funds could be injected into private markets through personal accounts than withdrawn through government borrowing. This would remain true until payroll tax surpluses are projected to last—through the year 2018.

"Issuing marketable recognition bonds to personal account participants—by between $4–$6 trillion depending on how they are calculated—would also increase federal debt held by the public. However, this increase also won't absorb current saving because the bonds would be awarded, not sold, in acknowledgement of workers' accrued benefits from their past payroll taxes.

"The reform-induced addition to outstanding government bonds would tend to depress their prices and increase their yields. The size of this effect will be minimized if the Federal Reserve continues to follow a monetary policy consistent with price stability. Furthermore, if the economy continues to recover, oil prices decline and stabilize, and capital inflows continue unabated, interest rates are unlikely to increase significantly faster than normal during economic recoveries. It is notable that despite an increase of almost $1 trillion in federal debt held by the public between 2001 and today, yields on long-term (20-year) Treasuries have not budged from their 2001 level of just over 5.0 percent.

"Future Social Security benefit obligations are not currently shown on official U.S. federal budget reports—and therein lies the value of such a reform. U.S. policymakers have recently shown a proclivity to amassing unfunded obligations under a shortsighted view of their size—Medicare prescription drugs, for example. The conversion of unreported obligations into explicit recognition bonds will reveal that federal indebtedness is much larger than is apparent under current accounting conventions. Even if this does not lead to a reduction in projected non-Social Security spending, it may constrain political incentives to further escalate such spending. And any reductions, if they occur, would increase government saving—ultimately improving the nation's capacity to pay off its obligations.

"What about the prices and returns on private securities? Unlike the earlier assumption, participants are not likely to devote their entire personal accounts to purchasing government bonds. Those who are constrained from investing in private markets today and who, post-reform, evaluate market risk premiums to be larger than warranted, would select riskier private securities, pushing up their prices and reducing their yield spreads over government bonds. Again, because small investors tend to be risk averse, this effect is likely to be small.

"One important caveat to remember is that the choice of market rise exposures through personal accounts would be affected by the protection offered against investment losses via Social Security benefit guarantees.

"Although personal accounts investments will likely be restricted to highly diversified stock and bond funds, these securities remain riskier than government bonds—including at very long horizons as evidenced by their persistent return premiums. Despite personal account regulations, very generous guarantees could induce excessive risk taking in an effort to bolster returns.

"The extent to which market risk premiums are reduced and private saving increased will depend primarily on the manner and amount by which other reform features reduce Social Security's future unfunded obligations. The larger the retrenchment achieved by announcing a cut the program's scheduled but unpayable benefits to today's younger workers and future generations, the greater the likely positive impact on private saving—which would tend to lower interest rates. Several recent studies on Chile's post-reform experience—that also involved recognition bonds—suggest a significant increase in saving as a result of the reform.

"A significant reduction in unfunded obligations in this manner will also reduce the risk premiums built into private equity returns: Such a reform will resolve early the uncertainty about future tax and benefit changes, thereby instilling greater confidence in the stability of a low-tax and growth oriented fiscal policy environment.

"A properly designed Social Security reform that resolves future uncertainties early, provides reasonable regulations against excessive risk taking, and does not replace today's overcommitment of Social Security benefits with a similar overcommitment of retirement income guarantees under personal accounts could boost national saving, improve the operation of capital markets, and increase economic growth. Ill-conceived measures and delays, however, could have the opposite effects."

Caroline Baum: George Bush Has Only a Narrow Window for Reform

Caroline Baum, a columnist for Bloomberg News, suggests that if President Bush is serious about overhauling Social Security, he will need to act fast. It is crucial for the president to release a plan and follow through with initiatives before he spends his new political capital elsewhere, writes Baum. Re-election is no longer an issue for a second term president; therefore, Bush has incentive to endorse policies with positive, long-term benefits such as Social Security. In her commentary, which follows, Baum stresses that now is the time to act.

“President George W. Bush was re-elected to a second term last week with 51 percent of the popular vote. He was the first incumbent president to be re-elected and pick up seats in both houses of Congress since 1936.

“Whether you can relate to Bush’s popularity in the heartland (large swaths of voters in the Northeast and on the West coast can’t) or can identify with his appeal to ‘moral values’ (are there any other kind?), you can’t deny that something significant happened last Tuesday.

“Now the question is, can Bush do something significant with it? Can he use the political capital he says he earned to reform Social Security and simplify the tax code?

“Second-term presidents are freed from the burden of facing the electorate again. That means they can choose good policy over good politics. They can focus on initiatives that have long-range benefits, even if there’s short-term pain. They can think about their legacy.

“They have only a narrow window in which to act.

“‘Second terms tend to resemble an hourglass with sand running out,’ says Stephen Hess, a presidential scholar at the liberal Brookings Institution in Washington. ‘By the time of the midterm election, the president becomes a lame duck, loses seats (in Congress), loses personnel and has problems replacing people, and people inside start to look to a new candidate. A president has to do what he can in the fifth and sixth year, especially the fifth.’

“No wonder Bush has come out swinging on his two big domestic initiatives following the election.

“‘We must reform our complicated and outdated tax code’ and strengthen ‘Social Security for our children and grandchildren,’ Bush said at a press conference Thursday.

“Bush has proposed allowing workers to divert part of their Social Security taxes into private retirement accounts.

“Under the current pay-as-you-go system, the taxes paid by today’s workers provide the benefits for today’s retirees. There is no saving, no compounding of interest, because there are no real assets in the trust fund.

“‘Those trust funds are mainly accounting mechanisms and contain no economic resources,’ the non-partisan Congressional Budget Office said in a June 2004 report, ‘The Outlook for Social Security.’

“In his first term, Bush appointed a Commission to Strengthen Social Security, co-chaired by the late Senator Daniel Patrick Moynihan. After a series of public hearings, the 16-member commission endorsed three scenarios, all of which involved a personal investment option.

“Social Security reform started and ended there—not for lack of interest on the part of the president, but because outside events (Sept. 11) intervened.

“If workers are going to start saving for themselves, the federal government will have to come up with an estimated $1 trillion to $2 trillion for retiree benefits over the next 10 years.

“While that’s a lot of money, ‘the transition cost is not a new cost,’ said Michael Tanner, director of the libertarian Cato Institute’s Project on Social Security Choice. ‘The costs exist in the future. We’d just be paying them today.’

“Social Security’s unfunded liability is $26 trillion (in real-dollar, not present value, terms), according to Tanner. The U.S. can’t grow its way out of it or tax its way out of it. The demographics are just too lopsided: too many old folks eligible to collect benefits over the next few decades to be supported by the dwindling number of working stiffs.

“Doing nothing is not a solution. Getting caught up in the transition plan is just a device to defer a problem that isn’t going away.

“‘It’s inconceivable that a country that put a man on the moon can’t come up with a transition plan’ once it decides to go ahead with a private pension system, said Jose Pinera, the founder and president of the International Center for Pension Reform and the architect of Chile’s pension privatization in 1980.

“Less developed countries (Hungary, Poland, Kazakhstan) have converted to a private pension system. Even ‘the cradle of the welfare state, Sweden, is allowing citizens to put 2.5 percent of the their wages into private accounts,’ Pinera said.

“Surely the U.S., with its highly developed capital markets, can come up with a plan.

“‘The transition is merely a menu to be defined by each country,’ he said. ‘It’s a cash-flow problem, not an economic cost, because you are reducing the unfunded liability.’

“The options include borrowing, taxing or cutting government spending in other areas. It’s a ‘budget discussion to be sold by technocrats with a blackboard,’ Pinera said.

“If Pinera had his druthers, he would have ‘changed the tax sequence,’ converting to a private pension system first ‘when there was a surplus to finance it’ and cutting taxes later, ‘once private savings accounts started generating a higher rate of return.’

“The Democrats tried to scare seniors in the 2000 presidential election, when Bush first introduced the idea of private accounts, and again in 2004, saying the president would cut Social Security benefits.

“‘It’s the first line of defense,’ said Tanner. ‘There are legitimate discussions to have about private accounts: how to manage the risks, what kind of safety net there will be and how to finance them. But they will not take money from seniors.’

“Even if the debate on Social Security reform keeps from degenerating into partisan bickering, Bush is bucking history when it comes to presidents implementing an ambitious second-term agenda, said Norman Ornstein, a presidential scholar at the American Enterprise Institute, a conservative Washington think tank.

"'Reagan's tax reform in 1986 was a counter example,' Ornstein said. 'It was a major policy change, but he had spent a lot of time building the groundwork. He started with strong, bipartisan support,' especially from Dan Rostenkowski, the powerful Democratic Chairman of the House Ways and Means Committee.

"Bush has a window, Ornstein said. 'But he has no plan out there and no mandate for the specifics. He will have a great deal of difficulty getting the specifics out before the window closes.'

"Simplifying the tax code is an even bigger hurdle."

AARP Prefers Higher Taxes, Benefit Cuts to Individual Accounts

An article in the North Carolina *Herald-Sun* this week features the comments of AARP's Bill Novelli and Ridge Multop on the subject of Social Security. AARP has long been an opponent of the partial privatization of Social Security, opting instead to endorse "minor" adjustments to the system—Multop, AARP's senior legislative representative, clarified exactly what sort of adjustments for the system AARP has in mind: higher taxes, an increase in the retirement age, and a raise in the taxable income cap. The text of the article follows.

"Social Security reform is on the way.

"At least, that's the word from the experts who spoke at a forum held at the Friday Center on Monday.

"Bill Novelli, the chief executive officer of AARP, the nation's largest organized group for senior citizens, said the battle over the future of Social Security is on the horizon.

"'People have heard that Social Security is in trouble,' Novelli said. 'The whole set of issues is rising to the surface.'

"Novelli told a panel of experts and a Friday Center audience that AARP was pushing for a different set of reforms instead of the partial privatization of the retirement plan that the White House is likely to propose during President Bush's second term.

"According to government calculations, by 2018 the Social Security fund will be running a deficit, meaning that more will be paid out in benefits than is taken in through taxes. But the efficiency of the current program will be tested sooner than that, Novelli said.

"'Many concerns will come to a head in 2011, when [more of the] 'baby boomers' reach retirement age,' he said. 'We need to take the right steps [now] as a nation.'

"Novelli said that AARP is lobbying around the U.S., holding forums and educating people on this issue. Longevity of life and better health practices are putting increasing pressure on the Social Security system, which needs to be made solvent for future generations.

"'It's of interest to the 'boomers' and it's of interest to young workers,' Novelli said. 'We have to work to make it strong.'

"AARP's Senior Legislative Representative Ridge Multop said that with the current system, 70 percent of benefits would be paid for the next 75 years, but that's not sufficient.

"'AARP says that 70 percent isn't good enough, we can do better then that,' Multop said. He said that options for strengthening Social Security include raising the payroll tax by one-half percentage point, gradually raising the age for collecting full benefits to 70 years old and raising maximum wages subject to payroll tax payments from $88,000 to $140,000.

"Partial privatization, the option favored by the president, allows an individual to take a portion of the payroll taxes they pay toward Social Security and invest it in a separate account. If the market does well, the investment would help supplement retirement income. But the individual investor also would assume the risk if the investment did not do well.

"There are a number of options available for reform, and partial privatization is just part of it, Novelli said.

"'But there are many better ways to fix the issue,' he said.

"David Blau, a UNC economics professor on the panel, contested AARP's views on private investment accounts. Blau said he sees partial privatization through investment accounts as an option not to be overlooked, since the other options would mean either decreasing benefits or increasing taxes.

"'If you increase taxes or cut benefits, it would be easy for the government to spend it elsewhere,' Blau said. 'Once a system is in place, it doesn't matter what irresponsible things politicians do.'

"The downside to private investment accounts, he acknowledged, is that there are real costs involved in setting them up, but that the cost could be distributed to all future beneficiaries of the program.

"'There are disadvantages and uncertainties involved in reforming the current system,' Blau said. 'But we shouldn't dismiss private investment accounts.'

"Novelli said the discussion is only just beginning.

"'[Social Security reform] is high on the president's agenda, which means it's high on the nation's agenda,' Novelli said. 'AARP welcomes the debate. We need to have it sooner rather than later. We look forward to seeing what the president has planned.'"

NCPA: President's Plan to Privatize Is Right on Target

Matt Moore, senior policy analyst at the National Center for Policy Analysis, writes in the *Washington Times* that Bush's plan to allow young workers to divert a portion of their payroll taxes into private accounts is both practical and just. Evidence shows that PRAs can be set up in a way that protects low-income and inexperienced investors while keeping administrative costs down, Moore reports. Not only will reform save American taxpayers $11 trillion, PRAs will pay out higher benefits to retirees, he concludes. His commentary follows.

"At the first press conference after his re-election, President Bush outlined the agenda for his next four years. When asked about the timeline for fulfilling his chief domestic campaign pledge to reform Social Security, the president replied, 'We'll start on Social Security now. We'll start bringing together those in Congress who agree with my assessment that we need to work together. We've got a good blueprint to go by.'

"The president's declaration should signify to everyone that Social Security is no longer the third rail of American politics. And that's a good thing. We younger workers were finally starting to notice that the system's $11 trillion long-term debt will come out of our pockets unless we do something to set the program on a fiscally sound track.

"So what should we expect from the president? What's this 'blueprint' he referred to? Back in 2001, President Bush assembled a 16-member bipartisan task force chaired by the late Sen. Daniel Patrick Moynihan, New York Democrat, to study Social Security's problems and find a way to allow today's workers to prefund part of their retirement benefits and reduce the system's long-term debt.

"In December 2001, the president's task force delivered a couple of different plans to do just that. The most prominent plan, often referred to as 'Model 2,' would create personal retirement accounts, which would allow younger workers to set aside part of their income in a personal account they can own and control, and will pay part of their benefits at retirement.

"Model 2 does not in any way affect current and near retirees; they would continue participating in the current system and receive scheduled benefit levels and cost-of-living increases. Under Model 2, a participating worker could invest in a personal retirement account by diverting 4 percentage points of the 12.4 percent payroll tax he and his employer already pay. The worker's expected benefit from the current Social Security system would be reduced by some factor based on what the worker accumulates in his account. As workers with personal accounts begin retiring and drawing a portion of their benefits from the accounts, the burden on future taxpayers would be significantly reduced.

"Would the president's plan work? Shortly after the commission finished its work, actuaries at the Social Security Administration examined the plan. Their conclusion? While the plan would require an initial infusion of funds—some $2 trillion over the next several decades—the plan saves about $11 trillion and sets the program on a path to fiscal sustainability.

"Readers should note: Social Security benefits under a reformed system should be compared to what Social Security can currently afford, not what it promises. The reason? The program can't meet its promises without a cash infusion of an extra $11 trillion. If we compare reformed benefits to what Social Security promises, we unfairly give the current system an $11 trillion 'leg-up' in the competition.

"The SSA says a median earner ($35,277 in 2002) Gen-Xer retiring in 2042 would receive a monthly benefit of $1,392 under Model 2, which is 128.8 percent of what Social Security can afford under the status quo. A low wage earner ($15,875) retiring in 2042 would receive a monthly benefit of $986 under Model 2, or 150 percent more than under the status quo, thanks to his personal account and the new minimum benefit rules included in Model 2.

"Some people worry about the details—administrative costs, low-income workers and inexperienced investors. But the Social Security Administration, the Government Accountability Office and the Congressional Budget Office show ways the accounts can be structured to keep administrative costs low, prop up the lower-income workers' accounts and protect inexperienced investors.

"The president is ready to get started on his second-term agenda. It looks like Social Security reform will be a top priority. The president's approach is not risky or scary. It is well thought out and fair."

Upcoming Events

The Center for American Progress, one of the more prominent opposition groups to private accounts, will be hosting a policy forum on Thursday, November 18, entitled "No Free Lunch: An Honest Accounting of Social Security Reform Options." For more information on the event, click here.

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