Social Insecurities

By: Andrew Brod

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Article:

President Bush says that the Social Security system is at risk and that dramatic reforms are needed in order to ensure its long-term health. This is a complicated topic, so let's get right to it. What follows are a few of the most important things one needs to understand about Social Security and the calls for reform.

Social Security was Reformed Already

In the late 1970s there were grave concerns that Social Security would go into deficit as early as the mid-1980s, and even graver concerns about the system's ability to support the huge demographic pulse known as the Baby Boom in its retirement. There was bipartisan consensus that something had to be done.

In response, President Reagan created a National Commission on Social Security Reform to study the system and make recommendations to ensure its integrity well into the future. The commission was chaired by Alan Greenspan, who is now the chairman of the Federal Reserve Board.

In 1983, the Greenspan Commission released its study and recommendations. Among them was an increase in the tax rate for Social Security to the current level of 12.4 percent (half of which is paid by employers). Because of that tax increase, Social Security has been taking in more than it pays out for about 20 years, with the excess going into a trust fund. The significance of this trust fund is central to the current debate.

Social Security Is Not A Savings Account

People are beginning to understand this, and in fact President Bush's campaign for privatized accounts has helped. But many people still seem to think that each year's 12.4 percent is put into an account with their name on it, where it earns interest and will be drawn down after their retirement. If that really were true, most retirees would exhaust their Social Security contributions (including interest) well before they die.

The simple fact is that Social Security is a program whereby current workers support current retirees. It's true that how much we pay into the system determines how much we receive in retirement. But by the time we retire, our actual contributions will be long gone, paid years earlier to support people who were retired while we were working. The workers of the future will support us.

Therefore, the only real issue as we look ahead is how much of our future national income will be needed to support future retirees. As our population ages, the burden on workers is indeed increasing. In 1950, 16 workers supported each retiree. Now it's about 3 workers per retiree, and the ratio is projected to fall to 2 workers per retiree by 2030.

Social Security Will Not Go Bankrupt In 2018

Suppose your annual spending outstrips your income. Are you bankrupt? Yes, if you have no wealth other than your income. But if you have wealth to draw upon, such as savings you can withdraw or stocks you can sell, then your wealth could make up for your personal deficit. So it is with Social Security. Reliable projections have the system going into deficit by 2018, which means that it will start paying out more than it takes in. If the system had no "wealth," that would be a serious problem.

But the system does have wealth; it has the Social Security trust fund. Thanks to the Reagan-Greenspan reforms, the system has been taking in more than it pays out each year, in preparation for the retirement of the Baby Boomers. By drawing down the trust fund after 2018, Social Security is expected to be solvent until 2042 and perhaps 2052. These dates are *not* outlandish claims made by liberals hell-bent on preserving Social Security no matter what. They're the projections of the Social Security Administration and the Congressional Budget Office, and if anything they're conservative guesses. And they lead to the next important point.

Social Security Is Not In Crisis

The most reasonable projections we have indicate that in 35 to 50 years (and maybe more), Social Security will exhaust the trust fund and no longer be able to pay full benefits to retirees. Along the way, it will have succeeded in addressing the most serious demographic challenge of our time, the retirement of the Baby Boomers. Anyone who thinks that this is a crisis is using a pretty creative definition of the word "crisis."

The Social Security Trust Fund Is Not A Sham

Those who insist that a crisis looms insist that 2018 is the real bankruptcy date because the trust fund is a sham, an artificial creation of government accounting. These commentators claim that all that's happening is that one arm of the government is borrowing from another. What they fail to explain is why this is bad.

After all, Social Security isn't investing in junk bonds or betting on Sweet Alexa in the 5th race at Belmont. It's investing in U.S. Treasury bonds, the safest investments on the planet. To claim that the trust fund is artificial is to believe that the U.S. government might default on its own securities.

If the U.S. were to renege on its obligations to Social Security after 2018, it wouldn't happen in a vacuum. It would send a loud signal to the rest of the world that our promises aren't worth the paper on which they're printed. In the world of finance, confidence is a delicate and yet essential commodity. The worst thing the U.S. government could do is give the foreign investors who finance our budget and trade deficits a reason to believe that Treasury bonds are a sham. If the government does this, Social Security will be the least of our worries.

A security is a promise to pay a certain amount to someone in the future. Therefore, the Social Security trust fund is a series of promises about how much of our future tax revenue will be paid to Social Security. Starting in 2018, the Social Security tax won't be enough to cover all the program's costs, and so the difference will have to be made up by revenues from other taxes like the income tax and the cigarette tax. How much will be dictated by the trust fund. To be sure, this may require tough choices, but there are always tough choices when it comes to the budget.

Besides, redeeming bonds from the trust fund isn't new. Since 1970 there have been 11 years in which Social Security has operated at a deficit, i.e. it paid out more than it took in. In *every* one of those years, the system obtained money from the trust fund and no one blew a gasket over it.

Private Accounts Wouldn't Ensure Social Security's Long-Term Health

One of the most publicized aspects of the president's reform proposals is to let people put up to 4 percent of their Social Security contribution, which is to say about a third of the 12.4 percent, into personal accounts. People would be able to control, to some degree, how the money in these accounts is invested. At first the administration claimed that partial privatization is essential to preserve the system's long-term integrity. But critics from across the political spectrum pointed out that the claim depends on faulty arithmetic, and the administration appears to be backing down and even agreeing that privatization is a separate issue.

Private Accounts Would Have No Effect On Many Retirement Portfolios

For most people, Social Security is just one of a number of ways they save for retirement. Because the system is rock-solid now, people have felt comfortable being more aggressive with their other investments, such as by buying stocks. If partial privatization makes Social Security investments riskier, the most likely outcome is that people will adjust their non-Social Security investments to become *less* risky. Their overall risk would be unchanged. To believe that private accounts would turn people into more aggressive investors, one has to believe that people are aching to add risk now but are somehow unable to do so. For everyone other than those who depend solely on Social Security, this is hard to believe.

Private Accounts Would Create Additional Costs

The largest of these costs would be to cover the transition to a system with private accounts. Every dollar diverted to a private account would be a dollar that could no longer be used to support retirees. Instead, that dollar would have to come from somewhere else, at least until the current retirees die and the owners of private accounts begin to retire and use the proceeds of their own savings. The Congressional Budget Office projects that the transition to private accounts might cost as much as $2 trillion in the first decade, and a total of about $15 trillion over 30 years. That’s a lot of money, and given our huge budget deficits, it would have to come either from higher taxes or reduced government services.

Social Security Needs Some Adjustment

The system is not in crisis, but it does need some small fixes to ensure its solvency beyond the 2050s. Cutting future benefits would work, but we don’t have to do that. Instead, we could increase the retirement age, which would reduce the number of years we have to support retirees. After all, people are living and working longer than when the 65-year-old retirement age was established in 1935.

Another possible adjustment would be to increase the cap on Social Security taxation. Currently, no income above $90,000 is subject to the 12.4 percent tax. Some people argue that there’s no reason to have any cap, but that’s an argument for another day. Raising the cap slightly, perhaps to as little as $ 100,000, would help solidify the system’s financial position.

Philosophy vs. Dollars

There are valid philosophical reasons to support dramatic Social Security reform and the creation of private accounts. But claiming that reform is necessary because the dollars and cents don’t add up is just wrong, according to the best non-partisan projections we have at our disposal. An honest discussion would focus on those philosophical issues. Unfortunately, that’s not the discussion we’re having.