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Killing Social Security Softly With Faux Kindness

L. Randall Wray Ph. D.

The Levy Economics Institute of Bard College

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KILLING SOCIAL SECURITY SOFTLY WITH FAUX KINDNESS

THE DRAFT REPORT BY THE PRESIDENT'S COMMISSION ON SOCIAL SECURITY REFORM

L. RANDALL WRAY

The President's commission claims that the Social Security program is "unsustainable" and requires a complete "overhaul." It also claims that the program is a bad deal for women and minorities. However, any honest accounting of all Social Security benefits finds that the program is a good deal for disadvantaged groups. Social Security will become a worse deal only if tomorrow's politicians slash benefits—as the commission presumes they will—or increase the taxation of the disadvantaged. A suspicious person might conclude that the reason the report uses such scare tactics is because its authors fear that future Congresses will indeed keep their promises to maintain Social Security. Hence, the urgent need to privatize today.

ON JULY 24, THE PRESIDENT'S COMMISSION on Social Security Reform approved the draft interim report that proclaimed that the Social Security system was "conceived and designed for a different era and a different economy" and that it now is "broken" and requires a "fundamental restructuring." The report was immediately attacked by a wide variety of critics, who recoiled at its tone and apparent biases. Representative Robert Matsui (D–Calif.) characterized the report as "an attempt to frighten the American public." House Democratic Leader Richard Gephardt (D–Mo.) echoed this sentiment when he argued that the commission was "trying to undermine public confidence" in Social Security. While the commission's cochairs conceded that "broken" was a poor choice of words, they insisted that the program is "unsustainable" and that the interim report accurately reports the facts surrounding the looming crisis.

L. RANDALL WRAY is a senior visiting scholar at the Levy Institute and professor of economics at the University of Missouri–Kansas City.

There are many things wrong with the report: errors of omission, factual errors, logical snafus, dubious interpretations of history and legislative intent, and transparent pandering to popular fears and myths. What is most annoying, however, is that the report would kill Social Security with faux kindness. It spares no homilies in its praise of Social Security's past, while insisting that the program has "itself reached retirement age" and no longer serves a who's who of politically correct groups: working women, African Americans, Hispanic Americans, young people, and low-income households. In order to ensure that Social Security will renew its commitment to these groups, the report asserts that major "reforms" must be undertaken. While the commissioners have stated that "the diversity of views, opinions, and political beliefs represented on this commission is critical to our ability to make an objective analysis," it is clear to an outside observer that the lauded "diversity of views" ran the full gamut from Y to Z—with the A-to-X views of the rest of the American population excluded from discussion. Indeed, the commissioners labeled critics of the report "know-nothings" and "Luddites" (Goldstein 2001). It appears that the authors of the report set out to kill Social Security through privatization and will spare no argument in this endeavor.

Congressional Goodwill?

New York Times columnist Paul Krugman has dismissed the report as "sheer, mean-spirited nonsense." While I believe he is correct, he did not clearly identify the nature of the "mean-spiritedness" pervading the report. The commission repeatedly claims that while Social Security may have served us well in the past, it is now nothing but an old workhorse that must be put out to pasture, to be replaced by a young Wall Street–bred filly (more on that later). But the commission's real mean-spiritedness is directed against future Congresses. The report repeatedly argues that the main defect of the current program is that it relies on the continued goodwill of Congress. When (if?) Social Security revenues fall short of promised benefit payments, those evil politicians of the future may be unwilling to continue to put the "full faith and credit" of the federal government behind those promises. Thus, the program must be "overhauled," in the view of the commission. The commission is short on specifics, but it notes that "in any retirement system a lack of legal ownership is a source of insecurity." Hence, "overhaul" is a euphemism for taking Social Security out of the hands of future Congresses—through the creation of individual retirement accounts "owned" by beneficiaries and managed by those same Wall Street wizards who have done such a wonderful job losing all the funds that flowed into dot-coms. The cochairs hastened to add in their postmeeting press conference that this measure would not amount to privatization.[1]

It has been observed that voters get the politicians they deserve—a view that I would not wish to defend, but one that sheds some light on the biases of this report. For the past 60-plus years, U.S. voters have held their politicians to a litmus test according to which the basic features of the Social Security program would remain off-limits. While there have always been critics of the program—including Ronald Reagan, beginning with his notorious "Operation Coffee Cup" speeches[2]—the naysayers have never stood a chance. Most changes made in the past actually expanded the program, creating more benefits, and casting a wider net, while gradually raising payroll tax rates.

The only truly significant modification came in 1983, with the Greenspan Commission's change from a "pay-as-you-go" arrangement to an "advance-funded" system that would accumulate hundreds of billions, even trillions, of surpluses. This modification required payroll tax increases that would generate the surpluses necessary to buy nonmarketable Treasury debt, purportedly putting Social Security on sure footing because the debt could be turned back to the Treasury as needed when the baby boomers retired, eliminating any future need to rely on the political goodwill of politicians. (Déjà vu all over again!) In the United States, it is believed that many things get better with time, with the notable exceptions of Social Security's finances and the intentions of Congress.

Ironically, the present commission is now using this surplus to push forward its privatization agenda. It claims that because the surplus was accumulated in the form of Treasury IOUs, future retirees are still subject to the whims of future Congresses because when the time comes to retire those IOUs, politicians might refuse to raise other taxes, cut other types of spending, or borrow in order to come up with the necessary funds to pay to Social Security. Instead, we need to provide "legal ownership" of those surpluses directly to prospective beneficiaries. That way, Congress will not be able to refuse payment. The argument that politicians will find Social Security recipients of the future any easier to ignore than those of the past strains credulity—especially since the percentage of the population that will collect Social Security has grown steadily and will continue to grow significantly in coming years. I expect that future voters will continue to hold politicians' feet to the fire of Social Security and assert their resolve to keep the program intact.

Because the commissioners recognize this resolve, they have resorted to scaremongering in an attempt to enlist the support of disadvantaged groups. According to the commission, Social Security is a bad deal—and will become a much worse deal—for women, racial minorities, and low-income households.[3] The commissioners pretend that Social Security is nothing but a retirement system so that they can ignore the substantial benefits it provides to surviving spouses, children, and disabled people. Indeed, nearly 30 percent of today's beneficiaries are spouses or survivors of covered workers; moreover, Social Security provides types of insurance coverage that either cannot be obtained in private markets or are prohibitively costly for most households. Any honest accounting of all Social Security benefits finds that it *is* a good deal for disadvantaged groups. Social Security will become a worse deal only if tomorrow's politicians slash benefits—as the commissioners presume they will—or increase the taxation of the disadvantaged. A suspicious person might conclude that the reason that report uses such scare tactics is because its authors fear that future Congresses will indeed keep their promises to maintain Social Security. Hence, the urgent need to privatize today.

The Nature and Scope of the "Crisis"

The draft interim report does contain two reasonably accurate arguments. The first has to do with projections of Social Security's finances. At some point in the distant future—perhaps by 2016—the program's payroll tax revenues might fall short of program spending. The report notes that more favorable assumptions push that date further into the future. Among the most important assumptions concerns the economic growth rate—rapid growth increases revenues faster than benefit payments, at least over the medium term. However, as the report warns, faster growth of wages will eventually raise benefit payments tied to wages earned. Thus in the longest term, rapid growth will only postpone the day of reckoning, not resolve the problem. Other factors that similarly postpone Armageddon include increases in immigration, the birth rate, labor force participation, and the retirement age, or (heaven forbid) a shorter average life span. Still, let us give the commissioners their due: at some point in the future, cash revenues might fall short of spending—the Greenspan commission's reason for advocating a transition to an advance funding scheme. However, as the report emphasizes, the sale of Social Security Trust Fund assets may improve Social Security's budget situation, but not the overall federal budget position. From the perspective of Uncle Sam, the trust fund is nothing but an accounting fiction, and when Social Security tries to "cash in" its assets, the Treasury will have to raise other taxes, cut other spending, or let its budget expand (reducing its overall surplus, if one exists at the time, or expanding its overall deficit). The commissioners presume that Uncle Sam will do nothing of the kind; rather, Congress will choose instead to slash Social Security benefits. For the reasons discussed above, this seems highly improbable.

Is there another solution? The size of the financial shortfall amounts to about 2 percent of GDP. Therefore, to completely resolve the looming financial "crisis" without worsening the overall federal budget balance will eventually require some combination of spending cuts and tax increases amounting to 2 percent of GDP. The report adopts extreme scare tactics in its discussion of possible scenarios: raising taxes imposed on a couple by $2,295 per year by 2050 or, more ominously, eliminating the Departments of Education, Interior, Justice, Veterans Affairs, and Commerce, along with the EPA, NASA, HUD, and the NSF. As Krugman has correctly pointed out, President Bush's tax cut will eventually reduce federal revenue by about 1.7 percent of GDP. Did any of his supporters note that this will require elimination of the above-named departments and agencies?

Social Security is unusual because it was based from the beginning on the fiction that its revenues are the source of the funds used to pay benefits. In reality, this has never been the case. Social Security checks come from the Treasury, just like any other form of government spending. Technically, the Treasury can continue to pay Social Security benefits even if payroll tax receipts fall to zero, although politically this could be difficult.[4] When the percentage of the population receiving Social Security benefits was small relative to that of the working population paying payroll taxes, it was politically useful to maintain the fiction of separate accounts. However, as the report makes clear, while there were five workers for every retiree in 1960, that ratio is now three to one, and it will fall eventually to about two to one. At the same time, the percentage of national income that is subject to payroll taxes has fallen and will continue to fall—from about 40 percent today to 35 percent by 2075, because (a) a higher percentage of national income is received in the form of nonwage income (as profit, rent, and interest) and hence is not subject to payroll taxes; and (b) income has become more unequally distributed, with a larger percentage of total income going to those at the upper reaches of the income scale and above the "wage cap" subject to the payroll tax ($76,200 in 2000, $80,400 in 2001).

Rather than seeing tax rates rise over the coming decades, we could actually have much lower tax rates if the tax base were expanded.

Hence, to move 2 percent more of GDP to Social Security would require a large increase in the payroll tax rate that is imposed on the current tax base—indeed, the report claims that payroll tax rates would have to rise by 37 percent by 2050 to eliminate the projected shortfall. However, a small tax increase imposed on a much broader base could easily increase revenue by 2 percent of GDP. At the limit, if the tax base included all national income, a Social Security tax rate of only 6.7 percent would cover all benefits to be paid in 2075! Contrast that with the current payroll tax rate of 12.4 percent of covered earnings (6.2 percent levied on both workers and their employers). In other words, rather than seeing tax rates rise over the coming decades, we could actually have much lower tax rates if the tax base were expanded. In 1960 it may well have made sense to pretend to finance Social Security on the basis of a payroll tax, given that there were plenty of workers to tax and few beneficiaries to support. However, as that ratio has continued to fall, it has made increasingly less sense to maintain such pretensions. As our population matures and the financial burden of providing for a large number of longer-lived individuals rises, that burden should be more equally shared—by high-income earners and even by those who receive nonwage income. Thus, let us *pretend* that a much lower tax rate on a much broader tax base "pays for" Social Security. Financial crisis resolved!

This brings us to the central issue, which is the real burden of providing for future retirees. Today, as the report correctly observes, for each retiree there are three workers producing Winnebagos, supervising shuffleboard games aboard Caribbean cruises, and fertilizing golf course greens. In the future there will be two workers per retiree; hence, the "real burden" on each will rise, regardless of the method adopted for financing Social Security. Indeed, the real burden will rise even if Social Security in its current form is retired, as the commissioners advocate. Even if privatization could provide each retiree with more financial wherewithal to buy Winnebagos, take cruises, or play golf, tomorrow's workers will still face a higher real burden of supporting more retirees. That burden can only be alleviated by increasing the number of workers (via more immigrants or more children per family, for example), reducing the number of retired people (via a higher retirement age or more smoking-related deaths, for instance), or *increasing worker productivity.*

It is almost impossible to conceive of a future so horrible that two workers in 2050 would not be able to do the work of three workers today. I expect that productivity growth over the next 50 years will create a whole new set of problems, precisely because it will be difficult to find enough useful work for all those highly productive workers of the future. But let us envision the worst-case scenario, espoused by the commission, in which it becomes necessary to take positive, discretionary actions to raise worker productivity. Will the commission's favored reform, privatization, succeed? The commission ruefully notes that to provide for retiring baby boomers, the nation must save and invest more, in order to increase the productivity of tomorrow's workers. The commissioners choose to believe that "ownership" of the payroll taxes paid would allow individuals to "save," thus providing funds directly to capital markets that would convert them into productivity-enhancing investments.

The commissioners are correct when they argue that too many Americans have little or no savings and that too many will accumulate insufficient financial wealth to see them through their retirement years. However, the Social Security program is not the cause of this state of affairs, nor can elimination of the program do anything but worsen it.

That all sounds very nice. Let us imagine for a moment that Wall Street has learned from the errors of its recent past, so that individual savings pumped into stocks won't disappear into dot-com lands of the future. Will a privatized "retirement" system encourage more individual investment in real brick-and-mortar-and-machines capital? It is not sufficient to encourage individual "saving," for saving can take any form, from stuffed mattresses to sovereign debt to Rembrandts. Economists distinguish between "liquid" (cash, bonds) and "illiquid" (factories) as well as between low-risk (bank CDs) and high-risk (telecom stocks) investments. It is a fundamental principle of portfolio management that one does not begin with high-risk and illiquid investments; only when a portfolio provides sufficient liquidity and low-risk returns to meet basic needs should chances begin to be taken. As actuary David Langer (2000) observes, professional actuaries recognize that private pension funds presume that Social Security provides a safety net for almost all retirees. Without such a safety net, prudent fund managers would have to adopt far safer positions. If the nation were to return to the pre–New Deal days in which most individuals had to rely on their own financial acumen

for retirement (and on their children when that proved insufficient, as it did for many of the elderly), it is dubious whether the supply of individual savings (including those professionally managed) flowing to Wall Street would actually increase. Far from promoting individual security—as the report claims it would—privatization would create insecurity because it would make individuals vulnerable to the fate of fickle financial markets. That is not likely to promote more investment in productivity-enhancing capital.

The commissioners are correct when they argue that too many Americans have little or no savings and that too many will accumulate insufficient financial wealth to see them through their retirement years. However, the Social Security program is not the cause of this state of affairs, nor can elimination of the program do anything but worsen it. The real source of the problem is the growing inequality of income and the deterioration of opportunities for advancement for too many Americans. If the commissioners were to devote their individual efforts to increasing the supply of good jobs, expanding educational opportunities, raising the minimum wage, providing universal health care coverage, and widening the social safety net, they would do much more to promote individual security than they are by attacking the most successful and popular government program ever adopted by our nation.

Conclusion

As the commission's interim report states, the number of workers supporting each retiree fell from 42 in 1940 to five in 1960 to just three today. The percent of GDP devoted to Social Security benefits grew from 0 in 1940 to about 5 today. These apparently massive changes did not generate any real "crisis," although many predicted that they would. Over the next 60-odd years, the number of workers supporting each retiree will fall from three to two, while the percent of GDP diverted to Social Security will rise from 5 to 7. These are rather small changes compared to what has happened over the past six decades. Crisis? No. Let us reserve that word for serious and immediate economic problems: the crumbling infrastructure in the nation's cities, the falling real living standards among the poor, an inadequate supply of decent jobs for low-skilled high school dropouts, and more than two million inmates—half of them African American males—in the nation's prisons and jails.

When we broach the topic of Social Security in my university class on economic policy, I ask students which of them doubts that the program will exist for them when they retire. Most raise their hands. Before they study the issues involved, most support elimination of the program, or at least some sort of privatization. After they have delved into the topic, they come to understand that if the program is analyzed strictly as a pension fund, it is a bad deal for most of them. But they also understand that Social Security is not simply or even primarily a retirement plan. Many experts have argued that it is actually an insurance system, providing a wide range of benefits that private insurance systems cannot offer, at least at a reasonable cost. I prefer to think of it as a social assurance program because "insurance" tends to bring to mind actuarial tables and reserve funds. The federal government does not, need not, and indeed cannot accumulate reserve funds—a point I have argued for years, and one the commission has come to recognize. However, Social Security benefits can and will be paid, without regard to the program's revenues, so long as congressional will is maintained.

I have found that even though Social Security is a hard sell to my students as a retirement program, it is an immediate and easy sell as an assurance program. I simply pose the following question: In, say, 2030, will you be willing to pay about 6.7 percent of your income to Social Security in order to gain assurance that your parents, grandparents, and great-grandparents (not to mention your widowed Aunt Sally with her children, and your disabled second cousin John) will not have to live in your home with you? One-hundred percent of my students have thus far agreed that on these terms the program is a good deal. Even leaving aside all the other "assurance" benefits for survivors and disabled people, this implicit, intergenerational promise—that Social Security will provide a minimum income sufficient to bring the vast majority of elderly persons above the poverty line, while allowing them to live with dignity and more or less independently—enjoys broad popular support. It may be true that voters deserve the politicians they get, but they certainly deserve better commission reports.

Notes

1. In the Q&A that followed, one commissioner voiced his hope that an individual could pass her "personal accounts" on to her children.
2. Although the "Operation Coffee Cup" speeches directly targeted Medicare, they sharply attacked Social Security as well. These attacks intensified over the years (Skidmore 1999).
3. In a response to the cochairs of the commission, economists Aaron, Blinder, Munnell, and Orszag (2001) argue that "the very study cited on this matter by the commissioners finds that when both life expectancies and earnings are taken into account, the average rate of return on Social Security is modestly higher for African-Americans than for whites and much higher for Hispanics than for whites." The claim that Social Security treats women worse than men is, quite simply, bizarre.
4. How many readers know whether the Department of Transportation's budget is in balance and whether it remains balanced in 2075? Does, or will, the Defense Department balance its budget? Does anyone care? The Social Security "crisis" exists—to whatever extent it does—because of peculiar accounting.

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