

# **A Poor Man's Update on Social Security**



By Gary Harding  
Massachusetts Route 128  
Chapter of the IMA

Copyright 2004 Garrett R. Harding

# Sources

- Wall Street Journal
- Report of the President's Commission, December 2001 - Strengthening Social Security and Creating Personal Wealth for all Americans
  - Co-Chairs - Daniel Patrick Moynihan and Richard Parsons
    - Co-Chief Operating Officer of AOL-Time Warner, a senior aide in the Ford administration; managing partner of a distinguished law firm; CEO of a major savings bank

# Sources

- Strengthening Social Security for the 21st Century, February 2004 - Office of the President of the U.S.
- The Concord Coalition's Series of Social Security Reform, Issue #1 and #2
- Facing Facts Quarterly, Vol 1 No 1 - Concord Coalition

# Sources - Concord Coalition

- The Concord Coalition is a nonpartisan, grassroots organization advocating fiscal responsibility while ensuring Social Security...[is] secure for all generations. Founded in 1992 by the late former Senator [Paul Tsongas](#) (D-Mass.), former Senator [Warren Rudman](#) (R-N.H.), and former U.S. Secretary of Commerce [Peter Peterson](#). Former Senator [Bob Kerrey](#) (D-Ne.) was named a co-chair of the Concord Coalition in January 2002.

# Sources

- 2004 Annual Report of the Board of Trustees of the Federal Old-age and Survivors Insurance (OASI) and Disability Insurance (DI) Trust Funds
  - AKA - 2004 Report of the Social Security Trustees or 2004 Trustees Report

# History

- Enacted 1935
- Trust Fund created in 1939
- Founders assumed it would be supplemented by individual forms of savings

# History - 1983

- Alan Greenspan, then a private economist
- Increased payroll taxes
- Reduced benefits
- Gradual increase of retirement age to 67 for full benefits

# Basics

- Pay-as-you-go system - today's workers pay benefits for today's retirees
- Payroll taxes are not saved in an account
- No property rights to its contributors
- Regressive tax



# Funding

- 1950 - 16.5 workers to support every one beneficiary
- Today - 3.3 workers to one beneficiary
- 2031 - 2.1 workers to one beneficiary
- 2040 - 2.0 workers to one beneficiary

# Current Status

- 2003
  - 47 million people receiving benefits
    - 33 million retirees, 7 million survivors, 8 million disabled workers
  - 154 million people paid payroll taxes
  - \$471 billion benefits paid
  - \$632 billion Income (taxes)
  - \$161 billion surplus for the year

# Problems

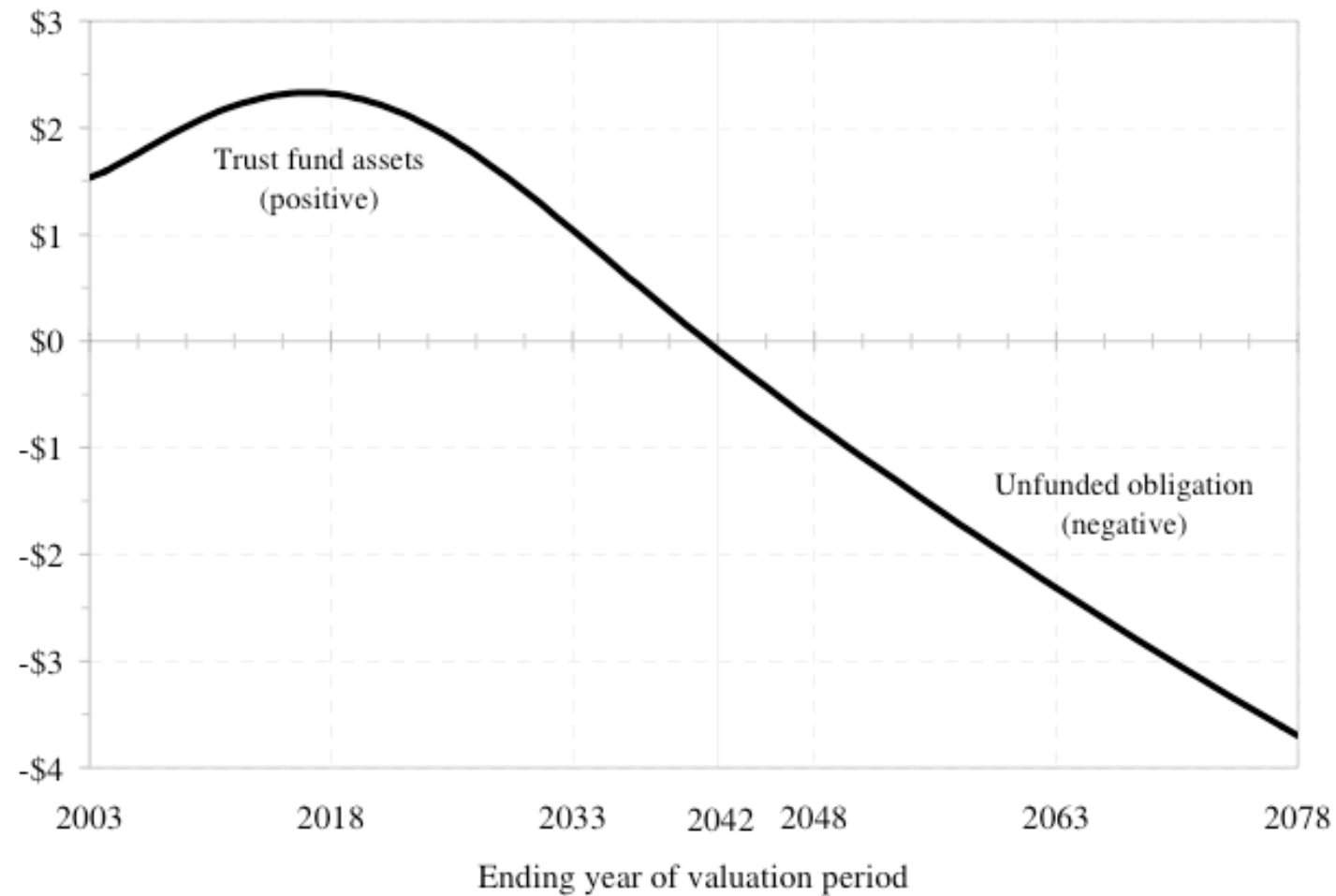
- Aging baby-boom generation (population bubble)
- Continuing low fertility (less kids to become workers)
- Increasing Life expectancy

# Future

- 2018 - Annual cost will exceed tax income
- 2042 - OASDI Trust Funds become insolvent
  - Insolvent - Unable to pay scheduled benefits in full on a timely basis.
- 2018 - Annual gap covered with cash from redeeming special obligations (bonds) of the Treasury
- 2042 - Bonds exhausted

**Figure II.D4.—Cumulative OASDI Income Less Cost, Based on Present Law Tax Rates and Scheduled Benefits**

[Present value as of January 1, 2004, in trillions]



# What can you change?

- Payroll tax rate
- Payroll tax maximum (ceiling)
- Age of retirement
- Amount of benefit
- Distribution - who gets what, means testing
- Change the index from wage to price

# President's Proposal

- Benefits untouched for people 55 and older (roughly 1/4 of US)
- Will not raise payroll taxes
- Personal accounts
  - \$1,000 first year
  - Over time maximum of 4% of wages
  - Investors choose from menu of conservative stock and bond funds
  - Life cycle portfolio (move from stocks to bonds)
  - Age 47 can opt out of portfolio - assume risk

# President's Proposal

- Personal accounts
  - Provide ownership control
  - Could be passed on to children and grandchildren
  - Pay out over time - annuity



# President's Proposal

- Personal accounts
  - Can't borrow before retirement
  - Low admin cost 0.3%
  - Start date 2009
  - Other countries have personal accounts

# President's Proposal

- Personal accounts
  - Available to workers born in 1950 or after
  - Workers born 1965 or earlier take control of their accounts in 2009
  - Workers born in 1978 or earlier take control of their accounts in 2010
  - All eligible workers participant in 2011

# Thrift Savings Plan

- Model for personal accounts
- Voluntary - offered to Federal employees
- 3.4 million participants
- Five broad-based investment funds
- Highly successful

# Key Players

- President Bush
- Senate Democratic Leader Harry Reid of Nevada
- Senate Finance Chairman Charles Grassley (R-Iowa)

# Trustees' Proposal

- Increase payroll taxes 1.89 percentage points (12.4% to 14.29%)
- Reduce benefits 12.6%
- General revenue transfers of \$3.7 trillion (present value) during the period
- Significantly larger changes would be required to maintain solvency beyond the 75 years

# Other Proposals

- Senator Lindsey Graham (R-SC)
  - Workers under 55 offered a choice
  - Stay in Social Security, Pay 2 percentage points, or
  - Divert 4% into personal accounts, guaranteed benefits 20% above the poverty line

# Other Proposals

- AARP
  - Leave program largely alone
  - Create “Add-on” accounts outside of Social Security

# Other Proposals

- Raising payroll tax wage ceiling
  - Today \$90,000 payroll tax wage ceiling - Taxes 85% of all wages
  - \$140,000 payroll tax wage ceiling in ten years - Taxes 90% of all wages and only fixes 40% of the problem



# Democrats vs Republicans

- Democrats - No discussion until personal accounts are off the table, only moderate adjustments are needed. Personal accounts - gambling with your future benefits
  - Need to recognize system is broken
- Republicans - Everything is on the table
  - Need to recognize personal accounts are not an end-all solution

# Personal Account Terminology

- Carve-outs
  - Diverting money from Social Security to personal accounts
- Add-ons
  - Personal accounts outside of Social Security
- Personal accounts = private accounts = privatization

# Personal Accounts vs Solvency

- Democrats - personal accounts do not address solvency. Funds are diverted from Social Security
- President - Personal accounts do not represent an increase in federal obligations - they “pre-fund” future benefits
- Today President acknowledged difficulty in selling the idea of personal accounts

# The Trust Fund Issue

- The fund is not a “nest egg” -it does not hold cash balances
- Surpluses - purchase special issue Treasury bonds
  - One arm of the government loaning the other
- Treasury uses the funds to pay for other government operations
- When it is time to pay back the bonds, the bonds will be sold to the public

# Investing the Trust Fund

- President Clinton proposed investing some of the fund
- The Trust Fund would become a significant investor
- Gives the Trust Fund too much influence over corporate governance
- Foreign investment?

# Conclusions

- Social Security needs to be addressed now
- The current design does not work
- Significant disagreement on how personal accounts fix Social Security
- Trust Fund is not in a “lock box” today
- Investing the Trust Fund is problematic

# Conclusions - Personal

- Raising the tax ceiling helps solve the problem
- Means testing - Directs funds to those who need it the most
- Raising payroll tax has not solved the problem in the past - other approaches should be considered
- Trust Fund monies should not be used to pay other government programs

# Conclusions - Personal

- Partial investment of Trust Fund monies needs serious consideration - global diversification
- Personal accounts are attractive - the Federal government demonstrated an inability to protect the Trust Fund
- Expect personal accounts to become “add-ons”



**Thank You!**



**Comments?**

