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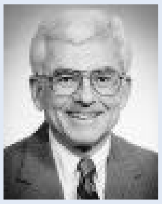

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EDITORIAL

The president's plan for Social Security

by Marc Twinney

Two years after the Advisory Council on Social Security issued its report and following many discussion forums on Social Security reform, the Clinton administration has come forth with its proposal. It contains two plans to transfer surplus tax revenue to Social Security and to invest part of the transfers in equities. Why the double dip — two proposals to invest in equities? An obvious reason is to improve the program's rate of return.

As we have reported and commented on Social Security reform, we have emphasized the importance of the overall rate of return on the program for all participants. Reforms that improve rather than lower the low real rate of slightly above 1% on the current program are important to the healthy growth of the national economy and to allow social adequacy and individual equity.

With that in mind, let's see how the reforms proposed in the January State of the Union address measure up. First, for 15 years the proposal would transfer from general revenues to the Social Security fund additional amounts much greater than the near-term surplus in FICA contributions. The transfer would be invested for the long term in equities and government bonds. Second, the proposal adds a new element—individual accounts on a relatively small scale to supplement Social Security's defined benefits and subsidizes the accounts from the general revenue with a flat dollar contribution that favors low earners.

Using general revenue for reform is the first novel idea in the proposals. During the long years of deficit spending, general revenue was strictly off limits for Social Security. This was true even though the Social Security program was then running a surplus and helped to offset $50 to $70 billion of general budget spending. Since the program's inception, the idea that it be self-supporting was considered necessary to preserve the perception that the program was a contributory, earnings-related pension.

The transfer of general revenue to the defined benefit programs based on today's projections of each year's current surplus may be helpful but could be a mixed blessing. The bulk of the transfer, invested in special issue government bonds that are not publicly traded, won't count as part of the public debt for most purposes. Even its interest will be a wash, the payment on the bonds from the Treasury exactly matching the credit to the trust fund.

The real return assumed on the bonds (2.8% in the 1998 Social Security Trustees' report, up from the 2.3% in the advisory council report) is much better than the long-term growth expected in real payroll. Using the budget surplus to reduce government debt, instead of switching it from the public to the nonpublic (Social Security) arena, would return the same 2.8% to the economy.

The transfer and interest will move the estimated date of fund exhaustion from 2032 to 2049. But it won't do anything to defer the estimated date (2013) when benefit payments start to exceed cash reserves, forcing either bonds to be sold to the public or general revenue to be tapped for cash.

The proposal would express the transfer (62% of the estimated surplus) year by year as a percentage of projected taxable payroll. The addition of this new tax revenue will hurt the benefit/tax ratio that drives the overall rate of return, offsetting the better return.

The proposal for a government agency to invest the trust fund in equities is controversial. The proposed level is relatively low, only 21% of the new funds from transfers until equity allocation reaches 14.6% of the entire fund. This allocation improves the long-term actuarial balance. It also helps to defer the estimated date of fund exhaustion for six years, from 2049 to 2055.

This gain in solvency seems small and may be hardly worth the trouble, given Alan Greenspan's adverse reaction within 24 hours of the State of the Union address and all the questions about how this investing would work. Investing the trust fund in equities seems to make sense only if one concludes that Social Security is more important than all the interests and obligations of the other stakeholders—other investors, private markets, governance of private enterprises, and even the people's elected representatives in the regulatory and legislative processes.

The proposal also defers making any of the hard choices in adjusting benefits that are addressed under all three plans or the increase in payroll taxes and Medicare tax under Robert Ball's plan in the advisory council report. For example, the cost of improvement in surviving spouses' benefits, reductions in cost of living, the future benefit accrual, and later retirement ages went untouched. Without these more conventional changes, the administration's proposal will not close the actuarial gap. We are facing large benefit expenditures because of the birth and mortality rates, even beyond the baby boom generation. The benefits climb from today's 11.5% to more than 19% of payroll in the long-range intermediate forecasts. That is a big mountain for a 12.4% payroll tax to climb, however augmented by fund returns and transfers.

The proposal to establish private accounts to be invested individually is encouraging. Its review in these pages will wait until more detail is available.

The public's voice (continued from page 1)

retirement benefits than men because of different work histories. Clinton repeated the president's proposals for reforming Social Security, while Dunn encouraged the audience to think about innovative new solutions. Dunn pointed to the low rate of return (2.2%) for young people in Social Security today versus the much higher rates of return in the stock market. In so doing, she did not highlight the value of the death and disability benefits or the redistributive features of the system, but the first panel picked up this point and amplified it.

Two panels were assembled for the event. The first included Cindy Hounsell, Executive Director of WISER (Women's Institute for a Secure Retirement), a nonprofit group devoted to educating women about retirement, and Jane Ross, deputy commissioner for policy, U.S. Social Security Administration. The second panel included Leanne Abdnor, executive director, Alliance for Worker Retirement Security; Heidi Hartmann, director and president, Institute for Women's Policy Research; Eugene Steuerle, senior fellow, Urban Institute; and myself. Unlike others on my panel, I did not take a position on the issues. As an Academy representative, my role was to provide information and implications. I gave a brief explanation of the solvency issues and the operations of the Social Security trust fund. Also, I prepared a paper for distribution before the teleconference ("Social Security Reform Options and Their Implications for Women").

All the panelists and speakers agreed that it's important to understand the differences between men and women with regard to life span, work history, income, and family roles. They also agreed that these issues should be factored into the U.S. Social Security debate, and most felt this hadn't yet happened. Trade-offs are the major barriers to solving Social Security's problems, they said, especially when it comes to women. Politicians seek solutions without losers, but almost by definition, any change that significantly improves the system's financial status is likely to create losers. Tax increases or benefit changes within the system's current framework will have a widely distributed (although very modest) effect on many participants, generally downward; in contrast, structural changes would have a much bigger impact on some participants, resulting in a more dramatic "win-lose" scenario.

Conference speakers and background materials pointed out the greater need for Social Security among elderly women than men:

- Sixty percent of Social Security beneficiaries are women. Most elderly women will eventually be alone.
- For 25% of elderly unmarried women, Social Security is their only form of income.
- Elderly unmarried women get 51% of their income from Social Security, compared to 39% for elderly unmarried men.
- In 1997, the median income for elderly unmarried women was $11,161, compared to $14,769 for men.
- The 1997 poverty rate for divorced elderly women was 22%, compared to 5% for married women and 18% for widows.

Wide views on reforms

Agreement among the panelists ended when the discussion turned to reforms.

At one end of the spectrum was Heidi Hartmann, who indicated she sees no crisis and that major changes in the system are unnecessary and undesirable. Her views are similar those of Robert J. Myers, former chief actuary of the U.S. Social Security

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