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MANUFACTURING A CRISIS: THE NEOCON ATTACK ON SOCIAL SECURITY

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From: *Peter H. Wehner, White House Director of Strategic Initiatives*
Subject: *Some Thoughts on Social Security*
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I wanted to provide to you our latest thinking (not for attribution) on Social Security reform. I don't need to tell you that this will be one of the most important conservative undertakings of modern times. If we succeed in reforming Social Security, it will rank as one of the most significant conservative governing achievements ever. . . . Our strategy will probably include speeches early this month to establish an important premise: the current system is heading for an iceberg. The notion that younger workers will receive anything like the benefits they have been promised is fiction, unless significant reforms are undertaken. We need to establish in the public mind a key fiscal fact: right now we are on an unsustainable course. That reality needs to be seared into the public consciousness. (Wall Street Journal 2005)

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For seven decades, the far right has never veered from its avowed mission to gut America's most comprehensive, successful, and popular safety net: Social Security. While it had won a few small battles (most notably, the Greenspan Commission's huge 1983 payroll tax hikes and two-year increase in the normal retirement age), its efforts never gained much political traction before 2000. Ironically, the Clinton administration provided some much-needed support to the conservative think tanks' preposterous claim that Social Security faces financial Armageddon. And candidate Al Gore's only significant campaign issue involved maintaining "lockboxes" to protect the trust fund by dedicating a portion of projected 15-year budget surpluses to the program.[1]

Those Clinton-era budget surpluses proved to possess a half-life shorter than that of the latest *American Idol* runner-up, but the Democratic Party's fib-and-flub may have done lasting damage to public confidence in the program's promises. Even as Social Security's supporters (rightly) object to the use of the word "crisis" in neoconservative propaganda, Republicans (rightly) remind us that President Clinton used the same word. And given that the Clinton-Gore option of using budget surpluses to "save" the program is now moot, there is little wonder that the plan proposed by Bush's 2001 President's Commission on Social Security Reform, which would include a partial privatization, has been resurrected.[2] The neocons are quite literally drooling with anticipation in recognition that they are closer than they've ever been to realizing their dream of creating a nation free of social safety nets, "*one of the most significant conservative governing achievements ever,*" as Peter Wehner oozed in his not-for-attribution internal memo.

In truth, *all* objective analyses show Social Security running huge surpluses through 2018, which will continue to add to the trust fund's current assets of more than $1.5 trillion; indeed, projected total program revenues will cover all promised benefits for nearly four decades, after which the Social Security trustees' intermediate assumptions suppose that program revenues will cover about three-quarters of promised benefits.

The White House has apparently enlisted its appointees at the Social Security Administration in its efforts to put a negative spin on these numbers (Pear 2005). They have joined forces with the neocons to talk about 10.5 or 11 trillions of dollars of "unfunded obligations" through a fantastical infinite horizon. However, as the actuary David Langer has long argued, the assumptions used in those intermediate projections have consistently proved to be overly pessimistic, and on more realistic assumptions (what the trustees label low-cost or "optimistic" assumptions—which have, in fact, proven to be spot-on over the past decade), program revenues will be more than sufficient to cover all promised benefits into the infinite future.

Leaving aside commentary on the usefulness of projecting program costs and revenues through infinity (no nation yet has ever persisted through infinite horizons), objective analysts have come up with any number of small adjustments that could eliminate even the trustees' most pessimistic projections of shortfalls. And while the neocons continually point to an "avalanche" of baby-boomer retirements, simple math shows that Social Security is fine long after most baby boomers are dead and buried—indeed most of the projected shortfall occurs after 2079.[3] In truth, any future financial shortfall results from the logic of assumed low economic growth, rising longevity, and continuation of today's low fertility rates—not from the advertised baby-boomer bulge. Very small changes to any of these variables produce huge changes to projections of program finances carried through eternity.

The neocons nevertheless have provided President Bush with a precise year for Armageddon: 2018, when payroll tax revenues are expected to first fall short of Social Security benefit payments. While it is widely recognized that interest receipts and then trust fund bond sales will maintain program solvency through 2042 (the independent Congressional Budget Office says 2052), Social Security's enemies argue that the program faces a crisis by 2018, because its trust funds are a fiction. As I've long argued, the trust funds cannot provide external financing for one of the government's own programs, because this is a case of the government "owing itself." At the same time, however, this means that it is logically impossible for any one of the government's programs to face a financial crisis on its own, because it is the overall budget that matters—not a single program's finances.

The neocons want to have it both ways at once: they argue that because Social Security is a government program, it cannot count as assets claims on the federal government, but at the same time they claim that because Social Security's finances are separate from the rest of the budget, the program can singly face its own financial crisis. Logically, if we are going to treat Social Security's finances as separate, then we must count its trust fund assets (Treasury debt) and interest earnings; in that case, it is impossible to claim that the program will be bust in 2018—it cannot face a shortfall before 2042 (or 2052). On the other hand, if Social Security is a part of the federal budget, then it cannot face insolvency unless the whole government goes bankrupt.

President Bush has willingly granted large tax reductions that amount to a reduction of tax revenue over the foreseeable future five times greater than the sum total of all the "red ink" forecast in the Social Security program by its enemies. He has done so while increasing military spending and creating prescription drug benefits that alone are as large as the Social Security shortfall. Indeed, the projections show that over the next decade, excluding Social Security's large surpluses, the rest of the budget will run up trillions in red ink without causing any alarm in Washington or financial markets. If governmental red ink really is problematic, these relatively certain and near-term trillions of deficits should weigh far more heavily on the public consciousness than trillions in a long-distant and highly uncertain future. In truth, a sovereign like the U.S. federal government cannot be forced into involuntary bankruptcy—a point recognized by all major bond-rating agencies. And it is not plausible to believe that either today's or tomorrow's policymakers will voluntarily default.

It would be easy to dismiss the current hysteria as much ado about nothing. The Bush administration has floated the idea of drastically cutting benefits in the far future, by eliminating wage indexation, so that future benefits would increase only at the rate of inflation. This would consign future retirees to a living standard that would never rise in inflation-adjusted terms. They would be able to buy only the basket of goods consumed by *today's* retirees; hence, their lifestyle would fall farther and farther behind what in the future would be deemed an "American" standard of living.[4] Such an outcome would be patently unfair and would be rejected by tomorrow's voters. Indeed, it is just plain silly to think that any "reform" legislated today—whether it is tax increases or benefit cuts—will constrain policymakers in 2042 or 2052.

The neocons know this. Their only real hope is to dismantle Social Security completely and to substitute "privatization" (under the cloak of the neocon slogan "ownership society"), which would produce high management fees for Wall Street and low returns for tomorrow's seniors.[5] With luck, this gutting of Social Security would produce sufficient hostility to the program that future voters would happily let the whole system die a timely death. While no one has publicly painted such a scenario, it certainly would qualify as the "most significant conservative governing achievement ever."

From the neocon perspective, this is a high-risk game, because as poverty rates rise among tomorrow's seniors owing to the evisceration of the safety net, there could well be a revival of New Deal fervor. The result could be a bigger and better version of Social Security without the 1930s compromises, which include the fiction that payroll taxes "pay for" the program; the regressive nature of payroll taxes (with high wages and unearned income exempt from the tax); the link between income received while working and benefit payments—so that the neediest seniors receive the lowest benefits; and the disincentives to hiring labor created by the employer portion of the tax. If the neocons have thought about this at all, they must have concluded that a bird in the hand is worth two in the Bush, so to speak. In any case, the neocons do seem to be predisposed to taking whatever gains they can get today while conceding to the devil whatever he might take tomorrow. As my teacher the late Hyman P. Minsky used to remark, the "friends" of free market capitalism often turn out to be its worst enemies.

Rival numbers purporting to demonstrate either that Social Security's finances are doomed or that the program will be sound for decades to come are going to be floated by the two (or more) sides to this issue in coming months. The neocons are betting that a well-financed campaign to obfuscate the issues will succeed for the simple reason that voters will turn against the program if they are sufficiently confused. And they are probably right—candidate Gore's proposal to "save" Social Security was so confusing that voters turned against him even though polls consistently showed that the public trusted Democrats more than Republicans on the subject of Social Security. Today, the enemies (with substantial help from Clinton, organized labor, and other Democrats) have successfully planted in the public mind the belief that the program faces a "financial crisis" at some point in the future. Supporters of the program probably will not succeed by playing a financial numbers game.

Is there a better way to protect the program?

Supporters of Social Security will have more success if they ignore the fairly esoteric financial numbers and focus on the "real burden" of providing for an aging population. Fundamentally, this boils down to the projection that while we have three workers today “supporting” each beneficiary, that will fall to only two workers sometime around mid-century. In real terms, that would qualify as a “crisis” if two workers in, say, 2050 were not able to produce as much as three today. Two questions follow from this. First, can we expect productivity (output per worker) to rise enough over the next half-century to ensure that two workers will, indeed, produce as much as three today? All reasonable projections—including those of the trustees—do suppose this. Indeed, over the past half-century, productivities of workers in manufacturing have doubled or tripled, depending on the industry—far more than what is necessary to guarantee that we will have enough output in 2050 to raise the living standards of retirees, workers, and other dependents.

Second, in the unlikely event that productivity does not rise by the necessary amount, is there any purely financial change we can make to the program, including privatization, that will prevent a “crisis”? The answer is clearly no. Getting more money into the hands of the elderly would—at best—just mean that they would bid more of tomorrow’s production away from workers and other dependents, leaving those groups worse off. Unless privatization can increase birth rates (or, god forbid, increase death rates—reducing longevity), it cannot change the ratio of workers to program beneficiaries. To be sure, potential remedies exist that could attenuate the crisis by raising the ratio of workers to retirees (through immigration, for example)—but privatization today is not one of them. If worse comes to worse and we have fewer workers per beneficiary and no increase in productivity, then in 2050 taxes will have to be raised (to reduce consumption by workers) or benefits cut (to reduce consumption by retirees)—or some combination of the two—but that is best left to voters in 2050.

Of course, one of the arguments for privatization is that it will somehow spur faster productivity growth. The favored mechanism is through increased saving rates that supposedly spur investment. This is wrong on too many levels to fully address here. For starters, however, (1) conventional estimates of increased growth attributed to additional saving are far too low to make much difference; and (2) the Bush tax cuts and Medicare drug benefits have added far more to long-term projections of budget deficits than an unreformed Social Security adds through the infinite horizon. Yet Congress passed these measures with little concern for the impact of “reduced” national saving on productivity growth. Again, all this is so confused that it embarrasses one even to confront the neocons with their own logic. In fact, budget deficits add to nongovernmental sector savings and allow private sector–led economic growth, a point rehearsed in many Levy Institute strategic analyses and demonstrated again by actual U.S. economic performance in recent years, yet seemingly beyond the grasp of conventional wisdom.

Finally, if we really want to use government to try to encourage saving, we can do that at no additional cost over Bush’s privatization scheme and without dismantling Social Security. The neocon privatizers admit that so-called “transitional costs” could be as much as $2 trillion, as we phase in private accounts while meeting commitments to retirees and those soon to retire (Stevenson 2005). The neocons appear perfectly willing to have the federal government borrow to pay for the transition, on the argument that financial markets prefer $2 trillion of deficits in the near future if this can eliminate the prospects of $10 trillion of deficits throughout eternity—a bizarre claim. Putting that argument aside, if these transitional deficits directly encouraged saving, and if this led to faster economic growth by raising productivity, then tomorrow’s burden on workers would be reduced. Rather than using this $2 trillion of red ink to finance transition costs, government could use it directly to subsidize voluntary personal saving accounts—by matching dollar-for-dollar deposits into approved financial instruments. This would achieve the objective of the President’s Commission to encourage savings and “ownership,” albeit without destroying Social Security’s promise to provide a safety net for those unlucky in work or investments.

However, if we really want to prepare for tomorrow’s seniors by increasing investment and productive capacity, we ought to do it directly, by putting into place the infrastructure that will be needed in an aging society: nursing homes and other long-term care facilities, independent living communities, aged-friendly public transportation systems, and senior citizen centers. The private sector will play a role in all of this, but there is also an important role to be played by government—contrary to the wisdom of neocons, who believe that the answer to any social problem is to reduce the size of government.

Notes

1. See Papadimitriou and Wray (1999) for a critical analysis of the proposal to add budget surpluses to the trust fund.
2. See Wray (2001) for a critique.
3. Of the estimated \$10.5–11 trillion shortfall over the infinite horizon, just over \$3.5 trillion accrues over the next 75 years. See Andrews (2005).
4. Today, Social Security benefits equal 42 percent of the earnings of an average worker retiring at 65; eliminating the wage indexation (but retaining price indexation) would cause benefits to fall gradually to only 20 percent of preretirement earnings. The worker retiring in 2075 would receive only 54 percent of the benefits now promised by law. See Weisman and Allen (2005).
5. There are many good refutations of the claims made by privatizers that real returns on personal accounts would reach 7 percent. For a recent analysis, see Krugman (2005), who argues that the gross return would probably be about 3.8 percent while management fees would run 1.1 percent (as they do in the British privatized system), reducing net returns to only 2.7 percent—barely above the implicit "return" in Social Security. Interestingly, many of those advocating privatization now admit that privatization alone cannot possibly resolve the "crisis"—which is why they now focus on benefit cuts (such as elimination of wage indexation).

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