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No Rush To Fix Social Security; They’d Blow It

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The majority of new House Democrats reportedly think that their opposition to free trade during the fall election was instrumental in their winning. Populist opinion in the 2006 congressional elections was that free trade would lead (or has led) to a widening gap between income groups. The idea is that trade among large emerging and developed economies does lead to growth in global income but also results in a redistribution of income from middle- and low-income workers to owners of capital in the U.S.

That view did appear to reward some Democrats in the fall elections. So now there is concern about whether the Trade Promotion Authority Act, set to expire at the end of June, will receive the necessary votes for an extension. This issue and Social Security solvency appear to be converging. Populist opinion seems to be that low- and some middle-income workers do not have the resources to make use of the alternative retirement vehicles created by Congress. As a result, these people are entirely or mostly dependent on Social Security in retirement, which leads to the growing concern about Social Security solvency.

Solvent System

First of all, Social Security today is solvent. The system takes in more than it pays out. Social Security revenues have been exceeding Social Security expenditures for decades. At the end of fiscal 2006, cumulative excess Social Security revenues totaled $1.99 trillion.

With a pay-as-you-go system — current workers paying for those retired — just enough revenue is needed to offset expenditures. Instead, revenue has been exceeding expenditures. So Congress simply spent that excess $1.99 trillion over the decades. The “lockbox” was raided. Since Social Security is not a savings or pension system, those dollars were spent.

However, the pay-as-you-go system combined with U.S. demographic implications means that the Social Security system, as currently structured, won’t be long-term solvent. But then, the system was never designed to be long-term solvent because it isn’t a savings system but a spending system.

The 1981-83 National Commission on Social Security Reform supposedly “fixed” Social Security by increasing tax rates from a combined — including Medicare — 9.35% rate in the early 1980s to 15.3% by 1990. That worked so well that revenues exceeded expenditures by $1.99 trillion and Congress spent that money on bridges to nowhere and other pork.

That $1.99 trillion has been spent — let’s be clear about that. The IOUs — Treasury bonds — are there. But to pay those IOUs, federal revenue will need to be diverted from discretionary federal spending programs to pay Social Security retirees or tax rates will need to be increased on workers to generate the necessary revenue.

Now Isn't The Time

That is the way this pay-as-you-go Social Security system is designed — address the problems at the time. They can't be addressed ahead of time without altering the system design. At some time, Social Security expenditures will exceed revenues. But it makes absolutely no sense to increase tax revenues now in anticipation of that time unless the current system is modified so the excess revenue can be saved. Barring that, options include waiting until expenditures exceed revenue and then decrease benefits annually by an amount equal to the revenue shortfall, or increase taxes or some combination. Eventually the demographics will force changes.

So we could continue the system as we know it until about the time that Social Security expenditures exceed revenues. Then, with mounting public pressure, members of Congress will respond. One option is to turn Social Security into a welfare system — most likely its destiny. This addresses the issue of globalization and its income redistribution effects by hiking the top maximum wage base subject to the Social Security tax to $150,000 or $160,000 — a trial balloon on this option has already been floated. That would do it as long as workers paying the incremental tax were disconnected from incremental benefits.

Another option, a 2% tax surcharge on all earnings above the maximum wage base — 1% from the employee and 1% from the employer — would also work as long as benefits were disconnected from those taxes. A trial balloon also went up on this alternative.

But such a step need be taken only when Social Security expenditures exceed revenues — not at this time. Some are thinking about such a step now. The scary part for capital markets is that President Bush hasn't ruled out either alternative. To even think about such drastic action now is foolhardy because the excess revenue would soon be spent by Congress on more pork.

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