It is Time to Fix Social Security

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The Nation faces great fiscal challenges. One is reducing the budget deficit. The President is committed to cutting the deficit in half during his second term through economic growth and significant spending restraint. The larger fiscal challenge facing the Nation, however, lies beyond the five-year budget window.

As the population ages and the baby-boom generation retires, entitlement programs for the elderly—Social Security and Medicare—will put gradual but substantial pressure on federal spending. The President has correctly called this "the real fiscal danger." This is why he made Social Security reform a centerpiece during the recent campaign.

The fiscal challenge posed by the Social Security system reflects simple demographic facts. Americans are having fewer children and living longer. As a result, fewer workers are paying Social Security taxes to support a growing number of retirees. In 1950, there were 16 workers paying into Social Security for every person receiving benefits. Now there are 3.3, and that number is projected to fall to 2 by the time today's young workers retire.

Because of this demographic shift, the current Social Security system is not sustainable. According to the Social Security Trustees, annual spending on Social Security will exceed the system's tax revenue in 2018, with deficits increasing from there. In total, Social Security has made promises that exceed its resources by more than $10 trillion in present value.

While there is no reason to change the system for those now retired or nearing retirement, the Nation needs to think anew about this vital program and strengthen it for the long term. Without reform, we will face little choice but vastly higher taxes and the resulting drag on economic growth. For example, putting Social Security permanently on a sustainable basis through a higher payroll tax would involve raising the tax rate from 12.4 percent of wages up to the earnings limit to 15.9 percent—an increase of $1,400 for a family making $40,000 a year. Delay only makes the required tax increases even larger.

Such large tax increases would have adverse effects on the overall economy. Ed Prescott, the most recent winner of the Nobel Prize in economics, has shown that a large part of the difference in performance between our economy and those in Europe is that Europeans work less because they are taxed more. Raising taxes to solve the Social Security shortfall would, in essence, make the U.S. economy more like those of Europe. That is not the direction we should be heading.

The President's Commission on Social Security proposed a number of possible reforms to fix the system. The Commission's proposals are consistent with the President's principles for reform. They do not make any changes for those at or near retirement. They do not raise taxes. And they put into place a system of voluntary personal accounts so that individuals can develop an ownership stake in their future.

Personal accounts would expand individuals' choices and give them the ability to receive the benefits of long-term investing. How much to put in stocks, bonds, or a money market fund is a personal decision that depends on a person's willingness to accept some risk to obtain higher expected return. Most financial advisers recommend that everyone should put at least some of their retirement savings into broadly diversified, low-cost equity funds. Yet millions of Americans do not now take advantage of this opportunity. A system of personal accounts would give all Americans better access to the equity investments that the wealthiest have long enjoyed.

While personal accounts can be an important element of a new, sustainable Social Security system, fixing Social Security will also require hard choices to ensure that promises do not exceed resources. But this should not deter us. Avoiding reform is not an option, and delay would leave us with fewer and less attractive choices.

In the upcoming debate over alternative proposals, everyone should be careful to avoid the sophistry of those opposed to reform. In particular, we should be wary of comparisons between a new, reformed Social Security system and current law. The benefits now scheduled for future generations under current law are not sustainable given the projected path of payroll tax revenue. They are empty promises. Unless a listener is discerning, empty promises will always have a superficial appeal.

Social Security plans should not be devised to echo the empty promises of the current system. The real test of a Social Security plan is whether it stabilizes the system's finances, avoids the sudden benefit cuts of a "do-nothing" path to insolvency, provides for a smooth rate of benefit growth, and enables the retirees of the future to enjoy the income protections that Social Security now provides to America's seniors.

The President is now developing the specifics of the Social Security reform he will advocate. One thing is certain: His proposal, like those examined by the Social Security Commission, will be a credible plan that puts the Social Security System on a firm foundation for generations to come.

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