
Fixing Social Security: Are Conservatives Up to the Job?

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Social Security stands without serious rival as the greatest achievement of modern American liberalism. Yet the program, the very foundation stone of the "welfare state," could become the site of a landmark achievement for modern conservatism as well. That will happen if conservatives can seize the opportunity they have over the next few years to lead the way toward reforms that will repair Social Security's intrinsic flaws.

The challenge is formidable, both politically and economically. It may confront conservatives, no less than liberals, with disagreeable choices. But the project is ennobled, as hard work often is, by the simple fact that it is absolutely necessary.

Dramatic change is coming for Social Security, one way or another. The only question is whether the change that comes will be creative and courageous enough to help Social

Security sustain itself for the long term and better fulfill the program's original promise.

That original promise was described in 1957 in the reflections of an early architect of the system: “[O]ur idea of social security,” said J. Douglas Brown, who had been a top congressional staffer during the New Deal and by 1957 was dean of the faculty at Princeton University, “was a **social** mechanism for the preservation of **individual** dignity [emphasis added]...a mechanism whereby the individual could...prevent dependency **through his own efforts**.”

The latter-day defenders of “traditional” Social Security seldom echo this early emphasis on individual dignity and self-support today. They more often praise the “collective” nature of the system, which “is about being part of a larger community that shares burdens and responsibilities,” as Minnesota’s late senator Paul Wellstone put it during last year’s election campaign.

It is that, too, of course. But when arguing for proposals to partially “privatize” Social Security through a system of regulated personal retirement accounts, conservatives may find it helpful to recall that they are harkening back to the original vision of Social Security—as a community device, to be sure, but one designed to make possible personal independence.

Not least among the difficulties facing those who seek real Social Security reform is the numbing complexity of the program and its problems. Confusion about the realities of Social Security—along with a measure of simple mental exhaustion—is common even

among educated, well-informed Americans. And that’s true even when they aren’t being deliberately confused about the issue for political purposes—which isn’t very often.

I come to this controversy not an economist or an expert of any sort, but as a journalist and commentator who has sought for years to find and share some basic understanding of an issue whose volatile politics are often as simplistic as its policy details are inscrutable.

That effort, against long odds, to comprehend the Social Security riddle has if nothing else given me a sense of the key facts a befuddled American needs to grasp to begin sensibly examining the nation’s options. The discussion that follows is organized around those critical realities.

Social Security must— and will—change

One encouraging message of the 2002 congressional election may be that Americans have finally gotten the sobering, fundamental message about Social Security—that change is inevitable. At least, many conservative commentators are encouraged. Many have hailed Republican victories last fall as a sign the Democratic Party’s “scare tactics” on Social Security don’t work anymore.

In a November guest column for the *Wall Street Journal*, former Minnesota congressman Vin Weber declared: “More and more Americans understand that we will either reform Social Security, or oversee its collapse.” The result, he wrote, is a “seismic shift

...in American politics,” transforming Democrats’ once-invincible “political talisman” into “a potent...issue for the GOP...if Republicans maintain their courage....”

Weber saluted a number of Republican candidates around the country who, he wrote, stood their ground on Social Security and won—including Minnesota’s new senator, Norm Coleman.

Actually, Coleman, like many Republican candidates, adjusted his ground slightly while digging in. He maintained his general support for proposals—championed by President George W. Bush during his 2000 campaign and since—to allow younger workers to redirect a portion of their Social Security taxes into personal retirement accounts. But Coleman vigorously distanced himself from the word “privatization” as a description for what he favors. That term, Republican campaign strategists had concluded, causes misunderstanding and alarm among elderly voters.

Coleman, in fact, went so far as to file a formal legal complaint alleging that Wellstone, his opponent, had violated election laws by falsely claiming Coleman favored “privatization.”

This war of words over a word was an excellent example of the unenlightening shouting matches Social Security too often inspires. “Privatization,” though commonly used in the past by proponents of personal accounts, may not be an especially apt description of the closely regulated retirement investment plans conservative reformers are proposing. Still, quarreling over what to call an idea helps few to understand it.

That said, it is true Democrats in Minnesota and elsewhere gained little last fall from warning that plans to change Social Security endanger retirees. Whether that represents an earthquake that can rearrange partisan loyalties, it surely seems to alter the landscape for Social Security debate.

It is remarkable that even the general idea of including stock market investments in Social Security’s future remains politically viable after a year and more of non-stop bloodletting and scandal on Wall Street. It may well be that voters 1) no longer fear Social Security reform will impoverish anyone in the short term and, more important, 2) understand that over the longer term something has to be done.

They are right about this. If there is one conclusion about Social Security that is agreed upon by virtually all observers—not only both proponents and opponents of “privatization,” but also neutral analysts at the Congressional Budget Office and the Social Security Administration itself—it is that program changes of some kind to keep Social Security solvent in the decades ahead should be made sooner rather than later. “The sooner adjustments are made, the smaller and less abrupt they will have to be,” says a recent report from Social Security’s trustees.

The importance of Social Security can hardly be overstated. By far America’s largest government program, it delivers almost 40 percent of all cash income received by Americans over age sixty-five, according to the CBO. Social Security benefits provide nearly 90 percent of the income of elderly

families in the lowest fifth of the income distribution, and a still substantial 25 percent to aged families in the top fifth of incomes.

The basic problem with the program is reasonably well understood. America's population is growing older, resulting in relatively more retirees being supported by relatively fewer workers. This trend will begin accelerating dramatically within the next decade, as the huge post-World War II baby boom generation reaches retirement age.

Today, according to Social Security's trustees, there are roughly 3.4 workers paying Social Security taxes for each beneficiary. That ratio will drop quickly to barely more than two workers per beneficiary in 2030. It will continue to fall slowly after that, largely because of low projected birth rates and increasing life expectancies.

By the mid 2070s (the end of the seventy-five-year horizon Social Security uses to calculate its financial health), slightly fewer than two workers will be paying Social Security taxes for each beneficiary.

These demographic facts put Social Security on a collision course with trouble because the program is a "pay-as-you-go" system. Despite the early architects' vision of Social Security as a device by which individuals would make provisions for their own old age, early expansions of benefits and postponements of tax increases turned the program into a device through which current taxpayers fund the benefits of current beneficiaries. (Only about 70 percent of Social Security beneficiaries

are retirees and their spouses. The bulk of the rest are disabled workers and the spouses and children of deceased or disabled workers. The disability and survivors portions of the program present special challenges for reform. For simplicity's sake, we will generally be considering here the retirement portion of Social Security.)

Just as Social Security's pay-as-you-go structure is the root of its future financing difficulties, the failure to understand that structure produces much of the public misunderstanding and resentment that interferes with calm debate of the challenge. Since the beginning, confusion on this score has not been an accident. As the Congressional Budget Office has written:

"One purpose of using payroll taxes [that is, a flat-rate tax on all eligible workers from the first dollar of wages] rather than income taxes or other sources of revenue was so that elderly beneficiaries would feel they had earned their benefits, whether or not they had really done so...Moreover, President [Franklin] Roosevelt believed that such an approach would help ensure that future policymakers would not be able to repeal the program."

FDR was shrewd in this, as in many things. Unfortunately, the same strategic misunderstanding that makes "repeal" of Social Security impossible makes needed reform very difficult.

It remains possible to admire the subtlety of the philosophical underpinnings of Social Security. The pay-as-you-go structure, through which each generation of workers supports the older generation that raised it, and is in

turn supported by younger workers when its time comes, was seen a way of preserving an intergenerational bargain as old as the human family itself.

“The interdependence of members of families ... and of the families within a small community...” FDR said, were the “simple means of security” known in “earlier days” that Social Security could institutionalize, even though the “complexities of great communities and of organized industry” had undermined those ancient arrangements.

But while Social Security in this sense “socialized” the tradition of intergenerational support, the program never discarded the idea of self-support. As J. Douglas Brown emphasized, it was considered critical that the size of one’s Social Security benefit would be (as it still is today) meaningfully determined by one’s “individual contribution to our economy,” as reflected in one’s wages and payroll tax payments, because “we still believe in America that a man should be rewarded according to his own efforts” and that “the motivation of the individual from within himself... is a primary and essential source of power in a free society.”

Social Security redistributes wealth in the sense that “retired workers with a history of low wages have always received a higher percentage of their preretirement earnings in monthly benefits than other retired workers do,” as the CBO puts it. “Nonetheless, workers who earned higher wages receive a higher level of monthly benefits.”

Yet for all their careful thinking about the social, psychological, and economic balances involved in their

undertaking, the creators of Social Security left their handiwork vulnerable in the long run by turning its financing into a pay-as-you-go system. The one development such a system cannot easily handle is precisely what Social Security now faces—a persistent decline in the number of workers relative to the number of beneficiaries.

Aggravating the problem is the fact that policymakers over the years were not able to resist the temptation to redistribute wealth in another way—from future generations to present generations. Calculations by the Congressional Research Service indicate that workers born in 1915—now eighty-eight years old—got back in benefits all of their Social Security contributions, plus interest, by the time they were sixty-eight. Workers born in 1965 will have to live to be ninety-two to enjoy a similar return.

Yet the older generations did provide for their own future support in one critical way—by raising large numbers of offspring. One of the most intriguing and unnerving assessments of the Social Security problem has been offered by Florida A&M economist Shirley Burggraf. She noted in her 1997 book *The Feminine Economy and Economic Man* that Social Security gives every adult a right to be supported in old age by the younger generation—including those adults without children, or without productive, dutiful children. This socializing of the economic payoff for parenthood, she says, has aggravated other trends in the modern economy that are making raising children a less and less rewarding

proposition in purely economic terms. The result, Burggraf says, is falling birth rates throughout the western world and crises in pension systems such as Social Security. Only by somehow restoring the economic incentives of family life can the imbalances ultimately be set right, she says.

Imbalance, at any rate, is at hand. Early in his administration, President Bush appointed a sixteen-member, bipartisan Commission to Strengthen Social Security. Its proposals for reform, including a partial switch to personal retirement accounts, are shaping the current Social Security debate. Among the commission's members were two former Minnesota congressmen—Republican Bill Frenzel and former Democrat Tim Penny, who ran for governor last year as the Independence Party nominee. The late Daniel Patrick Moynihan, the distinguished former Democratic U.S. senator from New York, was a commission co-chair.

The commission has quantified the Social Security problem with what it calls "Basic Social Security Math." Its bottom line is that as the ratio of workers to beneficiaries falls in the decades ahead, Social Security simply will not be able to pay the same relative level of benefits with today's payroll tax rate.

Today the Social Security payroll tax is set by law at 12.4 percent of taxable wages (half paid by the employee and half by the employer), up to an earnings limit of \$87,000.

As the worker-to-beneficiary ratio falls from roughly 3-to-1 to roughly 2-to-1, the affordable level of benefits

will plunge by about a third. The commission states plainly what voters seem to sense: "Under the existing system, Americans will soon face inescapable choices: cut Social Security benefits, raise taxes, cut other government spending, or borrow on an unprecedented scale.

"To do nothing is implicitly equivalent to advocacy of one or more of these options... Inaction is not a solution."

Trust Fund surpluses won't postpone the need for change

Timothy Taylor is an economist at St. Paul's Macalester College, managing editor of the *Journal of Economic Perspectives*, and a thoughtful supporter of personal accounts as a part of Social Security reform. Taylor reduces to a vivid metaphor the raging debate over when, exactly, Social Security's day of reckoning will arrive.

This dispute, Taylor says, is like arguing about the sinking of the *Titanic* and asking what, exactly, marked the "Official Moment of Disaster." Was it when the ocean liner bumped the iceberg, or several hours later when the last smokestack vanished beneath the North Atlantic?

The point is that the riddle can't be answered, but one thing is clear: the time to prevent the sinking was before the iceberg could no longer be avoided.

We know, Taylor says, when Social Security will first collide with hard fiscal and political reality. It will be the moment when the program's current benefit payments become larger than its current payroll tax collections. Social

Security's trustees now estimate the year of that event to be 2018—fifteen years from now. After that, Social Security's shortfalls will grow larger.

Yet critics of "privatization" will be quick to point out—and quite correctly—that Social Security will be able to draw on surplus balances in its "trust fund" when its current tax collections cease to cover its current expenses. Those surpluses, these critics say, will allow Social Security to keep paying promised benefit levels until 2042—thirty-eight years from now. That date stirs much less urgency, and is commonly used as an argument against making drastic changes in the program.

The Social Security trust fund, and its surpluses, are another primary cause of confusion, disagreement, and resentment in the reform debate.

The trouble is that this trust fund, with its hefty balances, is not what it sounds like. It is not a reservoir of actual accumulated assets upon which the government can draw to pay benefits. It is rather a legal claim that the Social Security system has on the federal treasury—that is, a claim on future taxpayers. It is money the federal government owes to itself.

The point is worth some emphasis. The Congressional Research Service has explained:

"Contrary to popular belief, Social Security taxes are not deposited into the Social Security trust funds. They ... become part of the government's operating cash pool ... They are accounted for separately through the issuance of federal securities to the Social Security trust funds—which

basically involves a series of book-keeping entries

"When the government issues a security to one of its own accounts, it hasn't purchased anything or established a claim against some other ... entity. It is simply creating an IOU from one of its accounts to another. Hence, the building up of federal securities in federal trust funds—like those of Social Security—is not a means in and of itself for the government to accumulate assets."

What's more, the CBO noted in a recent report that over half of the surplus revenue now increasing the trust fund balance consists not of excess cash payroll tax receipts but of interest payments being credited to the trust fund's securities. In other words, it consists of additional IOUs to pay a return on the IOUs already there.

It is very important to realize that none of this means there is anything "unreal" about the trust fund's holdings. The government securities credited to the trust fund are binding obligations of the federal government that will be honored. The trust fund began consistently accumulating surpluses after dramatic 1983 program changes (basically, tax hikes, and benefit cuts) were enacted to head off short-run insolvency and to begin preparing for the retirement of the baby boomers. Today the trust fund balance is over \$1 trillion. It will continue to grow rapidly for another two decades.

But the fact that this "balance" consists only of the federal government's

own IOUs does mean that Social Security's surpluses have not been set aside or saved in any real sense. The popular, shorthand version of this situation—that the government has simply been “borrowing” and “spending” the surpluses—is essentially correct.

This doesn't necessarily prove, however, that the surpluses have done nothing to help prepare the nation for the burden of an aging population. Some argue that the Social Security surpluses, by helping to cover general government expenses over the past two decades, have kept annual federal deficits—and therefore accumulated national debt—lower than they otherwise would have been. This, if it happened, would have had the effect of increasing total savings in the economy, spurring investment, and increasing economic growth. If the economy is larger today as a result, the nation is better positioned to deal with future burdens than it otherwise would have been.

Unfortunately, there is no way to know whether this has happened, or to what extent. Many critics have complained for years that Social Security surpluses have only allowed politicians to spend more on current programs, or keep other taxes lower—in effect concealing, rather than reducing, the actual total deficit. It is certainly not difficult to imagine politicians responding that way. Also, the generally large deficits and modest economic growth over the last twenty years offers no clear evidence that Social Security surpluses have been boosting national savings and investment.

In any case, the suspicion that Social Security surpluses have been misused helped inspire a consensus in the late 1990s that henceforth trust fund surpluses should be placed in a “lockbox” and set aside in some manner for Social Security.

What is clear is that Social Security trust fund balances, as currently constituted, are not concrete assets for the federal government as a whole to use to pay future benefits. Instead, the creation two decades ago of a stream of ongoing surpluses accomplished the considerable political magic of, in effect, levying taxes on the future.

When the future arrives, in about 2018, and current payroll taxes are no longer sufficient to pay promised benefits, the Social Security Administration will start redeeming its trust fund securities to make up the difference. The resources to retire those bonds will have to be drawn from the non-Social Security budget, financed through tax increases, spending cuts, or borrowing. And the amount required will steadily climb.

The political tensions that situation will produce are easily imagined. While the government is legally obligated to make good the IOUs the trust funds hold, it is not obligated to continue paying any particular level of Social Security benefits. Those benefits have been changed in the past—both raised and cut—and can be changed again at any time.

Once Social Security starts draining government's coffers rather than swelling them, the temptation may be considerable for Congress to reduce the

overall burden of the program. However, the political risks of cutting benefits to many millions of baby boom retirees will also be formidable.

Macalester's Taylor notes that the lockbox debate was a low-intensity preview of what America will face come 2018. In practice, putting Social Security surpluses in a lockbox meant that the non-Social Security budget needed to run surpluses of its own at least as large as the Social Security surpluses. Washington came close to that only for a few years, until a recession and the war on terror sent the budget back into deficit.

Say, if you like, that recent events have been exceptional. The future may produce exceptional events, too. But once Social Security is no longer paying its own way, the rest of government will have to come up with additional resources to fill the gap, whatever difficulties it faces, so long as cost levels remain the same.

In short, the currently promised benefits workers are counting on will be subject to political risks much sooner than 2042. Those very real risks should be kept in mind when critics of personal account-based reform raise warnings about exposing Social Security to the hazards of financial markets.

Social Security will stay afloat even after it ceases to accumulate surpluses, just as the *Titanic* stayed afloat for a time after hitting the iceberg. But no one has ever supposed that the last hours of the cruise were enjoyable.

Personal accounts don't solve the problem, but help make a solution possible

What's most impressive about the proposals for Social Security reform put forward by President Bush's Commission to Strengthen Social Security is that they prescribe strong medicine. The proposals contemplate serious reductions in traditional benefits. Also, to make possible the transition to compensating personal accounts, the commission proposals call for the injection of significant new revenues into Social Security. That transition funding could require tax increases. In other words, the commission proposals face the problem squarely and do not pretend to offer painless answers.

Much of the criticism of the commission's ideas, whether scholarly or political, has been less forthright. More thoughtful critics allow that substantial changes to the system will be needed, with or without personal accounts. But most detractors insist on making unfavorable comparisons between the total retirement benefits the commission's plans would produce and the benefits promised under "current law," which they sometimes call "guaranteed benefits."

The trouble is, under actual "current law," the only thing "guaranteed" is a punishing drop in benefits once the trust fund is exhausted in the early 2040s. It is true policymakers almost certainly won't let that happen. Something will be done. But that's just the

point. The commission's plans represent one concrete "something" that could be done. To simply ignore the fact that current payroll tax rates cannot finance currently promised benefits is to force the commission proposals to compete with a wish rather than an alternative.

Another *Titanic* analogy comes to mind. If a passenger on that ill-fated vessel had refused to abandon ship because she couldn't possibly arrive in New York on the promised schedule aboard a lifeboat, she might have been fairly accused of failing to grasp the main fact in her situation.

Yet opponents of personal account-based reform seem reluctant to propose a specific remedy of their own to Social Security's challenge, preferring instead to speak of "modest adjustments" and the like. It is not that concrete alternatives are unavailable. For example, Social Security's trustees report that "the financial adequacy of the program for the next seventy-five years could be restored (under the trustees' best estimates), if the Social Security payroll tax were immediately and permanently increased, from its current level of 12.4 percent (combined employee-employer shares) to 14.27 percent."

That solution would produce an immediate and permanent payroll tax hike of \$1,000 a year for every family with wages of some \$53,500—or \$500 a year for families with wages of just under \$27,000. (Although employers nominally pay half the payroll tax, economists agree that this portion primarily falls on workers in the form of lower wages.)

The trustees also observe that such a tax increase would not lastingly resolve Social Security's imbalances. The system, they project, would face insolvency again after seventy-five years. The commission plans, by contrast, would ensure solvency well beyond that date.

Pundits and politicians eager to denounce personal account reform plans cannot be considered credible until they frankly advocate for the kind of tax increases (or corresponding benefit cuts) that constitute real alternatives—and which may not sound so "modest" once they are spelled out.

Meanwhile, conservatives drawn to personal-account proposals should recognize that private retirement accounts are neither necessary, in any technical sense, nor sufficient to restore Social Security's balance.

But moving Social Security toward personal accounts could contribute two indispensable ingredients to a recipe for reform. First, accounts could help make politically palatable the difficult measures that will be needed, with or without accounts, to balance Social Security's books. Second, personal accounts could provide a workable mechanism for transforming Social Security, in part, into a true "funded" pension system that is lastingly solvent and enhances the nation's ability to support its aging population.

The president's commission has proposed three alternative reform plans for policymakers' consideration. There are significant differences among the plans. But it is possible, without becoming overwhelmed with detail, to

describe the basic outline of personal account-based reform.

First, such a reform would restore Social Security's long-term financial balance primarily by phasing in substantial reductions in the "traditional" benefits Social Security is scheduled to pay future retirees. To be more exact, this means that future benefit *growth* would be curtailed, not that future traditional benefits would be lower than today's. Importantly, those currently retired or soon-to-retire would not be affected.

Various technical mechanisms could be used to accomplish these reductions, and they are the subject of vigorous debate in terms of their equity and the ways they would affect different beneficiaries. But the bottom line remains that future retirees would receive traditional benefits considerably smaller than those Social Security currently promises—but is unable to afford.

Second, younger workers would have the option of diverting a limited portion of their payroll taxes into a personal retirement account. The account would be the legal property of the worker, in a way eligibility for traditional Social Security benefits is not. Yet investment alternatives would be closely regulated. Aggressive speculation would not be permitted.

Upon retirement, the worker would choose among regulated options for drawing upon the account, i.e., turning it into an annuity to provide retirement income, taking a lump-sum payment, or making some or all of the resources available to pass on to heirs as a bequest.

Workers who choose the account option would see their traditional Social Security benefits reduced further, by the amount of the diversion plus a modest rate of interest. The aim would be to ensure that even workers choosing the most conservative investment option would come out ahead over time. Critics note that this arrangement means the Social Security system as a whole would be subsidizing personal accounts.

Because traditional benefits would continue to be paid to current and soon-to-be retirees, the redirection of payroll taxes into personal accounts would add to Social Security's financial shortfalls. This creates what are commonly called the "transition costs" of reform. The commission anticipates the infusion of new funds to cover these costs, which will not be small. Depending on the precise design of the ultimate system, and depending on whether one adopts the calculations of personal account proponents or foes, the total transition funding required over the years to come would likely be between \$1 trillion and \$2 trillion in present-value terms (the amount of money that, if set aside today, would, with interest, retire the future obligation).

While arguing that transition funding is not a true cost but an investment that will pay handsome returns to the nation over time, the commission did not specify where the resources should come from. It declined to do so for the obvious reason that the debate over where to find new resources will have to occur no matter what the design of Social Security in the future. To take a

position on what the source of new resources should be could easily distract attention from the relative merits of different approaches to reform—all of which will require new resources from somewhere.

About now, in fact, conservative readers may see taking shape in their own minds the kind of distraction the commission was worried about. Of course most conservatives will argue that new resources for Social Security should come from reduced spending elsewhere in government, not from increased levies of any kind. I will not dispute the excellence of such arguments.

But in the end, political expediency and compromise will determine what mix of spending cuts and tax hikes proves possible. If conservatives mean to lead real reform of Social Security, they must be prepared to face political realities as well as economic ones.

Critics of personal accounts decry the commission's failure to specify a funding source as the "magic asterisk" in its plans. But again, until critics acknowledge their own magic asterisk—the even larger infusion of new monies that would be necessary to preserve the current program—these criticisms have little weight.

What would be the net effect on future retirees of commission-like plans? The effect would vary by workers' circumstances and market conditions when they retire, of course. The commission plans include measures to significantly improve the typical retirement incomes of lower-wage workers. This also means that account-based

reform could provide people of modest means a much-improved opportunity to build wealth, as well as affording them a chance to bequeath resources to their families or favorite charities.

For better-off workers, the results would be more mixed. In general it is fair to say that workers with middle incomes and above who opt for personal accounts would on average be likely to receive total inflation-adjusted benefits (including the income from accounts) higher than today's retirees receive and higher than the benefits today's payroll tax rates could support. But their total benefits could be slightly lower than the benefits that are now promised (and which can't be delivered without big tax increases).

If those results seem disappointing to some, a bit of realism is in order. It would be incredible if any reform plan could claim to restore Social Security's long-term balance without severe tax increases—*and without any reduction in the growth of future benefits*. As it is, account-based reform promises to rescue the system and boost benefits for low-income workers, while only modestly trimming growth in overall benefits for the better off. In the real world, that's quite an achievement.

Causes for concern include the danger to workers who may want or need to retire at a particularly disadvantageous future moment, after a sharp stock market correction, say. Their retirement income could be seriously reduced. As noted earlier, benefits for disabled workers and survivors also present special difficulties. In many cases, those beneficiaries will not have had

sufficient time to build up resources in personal accounts. Protections against these kinds of risks may be needed, as the commission frankly acknowledged. They will add to the costs of reform.

Candidly admitting all the complexities in adding personal accounts to Social Security, it simply remains unclear how the tough and prompt choices required to set the system right can be made without them.

Some combination of benefit reductions, spending cuts in other programs, or tax increases will be needed to ensure Social Security's future. Whatever the ultimate mix, the advent of personal accounts could help the public accept what it must accept.

Today there is widespread and perfectly justifiable skepticism about Social Security, especially among younger workers. Workers perceive that they have been paying hefty payroll taxes that have mostly been used to fuel general government spending and to fund benefits for past and present retirees that constitute a very generous return on their contributions to the system. Yet the younger generation's own, less remunerative retirement benefits are in peril.

To ask voters in this state of mind for further sacrifices on behalf of an unchanged system would require more courage than politicians have been able to summon.

The addition of personal retirement accounts could fundamentally change this political mood. In exchange for smaller traditional benefits, other spending cuts, higher taxes, or all three, younger workers would for the

first time have real ownership and a measure of control over some of the dollars they are contributing to the system. In old age, they would have far more flexibility in how to use their resources. Partial or temporary retirement, for example, would be much easier with a personal account supplementing traditional benefits.

In other words, personal accounts would give younger workers something new and appealing in exchange for the sacrifices they must be asked to make. The new system would ensure that whatever cuts or costs workers face would serve directly to bolster their own retirement, and would not be smuggled into other spending programs or into benefit improvements for others.

Personal accounts also provide the most workable device for moving Social Security toward becoming a "funded" pension system—a direction nearly everyone agrees is desirable.

A funded system can be distinguished from a pay-as-you-go plan in that a funded plan actually sets resources aside to pay future benefits. One great advantage is that a funded system is not vulnerable to the kinds of unforeseeable demographic shifts that today threaten Social Security. In short, the problem would stay solved.

Pre-funding Social Security, at least in part, would also boost America's low national savings rate, fueling additional productive investment or at least cushioning the economy against the possibility that inflows of capital from foreign countries may not always be as large as they have been in recent

decades. The result will be stronger economic growth, which is ultimately what will be needed to provide for the future's large population of elderly.

It is easy in all economic discussions to think too much in terms of money and too little in terms of the tangible things economics is really about, and for which money is only a voucher. Tomorrow's retirees will not eat dollars or live in houses constructed of trust fund balances. The cars they drive and the haircuts they get will have to be physically produced and provided at the time. A bigger, more productive economy will find it easier to satisfy what will be a high-consumption society.

This larger concern with economic growth becomes especially urgent when one considers not just Social Security but also America's other costly programs for the aged—Medicare and the long-term care portion of Medicaid—which are approaching the same demographic iceberg. The Congressional Budget Office has reported that these three programs together account today for nearly half of all non-interest federal spending and consume roughly 7.5 percent of the nation's gross domestic product, or total economic output. By 2030, says CBO, the three programs as currently constituted would absorb two-thirds of federal spending and 15 percent of GDP.

Yet the adjustment to these programs that seems most likely to emerge from Congress this year is the addition of a costly prescription drug benefit to Medicare. A Bush administration proposal that a drug benefit be accompanied by comprehensive reform of

Medicare—bringing competition to bear to control costs—is another responsible but politically risky effort to lead the nation toward engaging its long-term challenges.

It is perhaps not surprising in the face of these looming burdens that the wisdom of at least partly pre-funding Social Security—and thus enhancing savings, investment, and economic growth—is one point on which there is little dispute. Pre-funding was the goal of the lockbox strategy to reserve Social Security surpluses for federal debt reduction. It is also the objective of suggestions—at one time advanced by the Clinton administration—that Social Security surpluses could be invested collectively in private markets, rather like public employee pension funds.

But the political hazards of such an unprecedented government role in private markets are daunting. Any serious attempt at pre-funding Social Security would soon produce a fund that would make Social Security a dominant player in every investment market in America—stocks, bonds, state and local debt, real estate. The government would hold a substantial interest in thousands of private enterprises. Every market correction would produce billions, perhaps hundreds of billions, in losses to the government's investment fund.

Could politicians resist the temptation to politicize investment decisions in such a fund, or to intervene in stumbling markets when trust fund losses mounted? It is impossible to believe it. Even if strong institutional structures were erected to prevent political

manipulation, the irreducible risk of political intervention could distort market and business behavior in unpredictable ways.

A system of personal accounts would not be invulnerable to politics—say in the design of investment options. But the temptation would be smaller, and the potential consequences of playing political games with the private property of millions of Americans would be formidable.

If it makes sense to actually set aside resources now for the nation's future needs—which is what turning Social Security into a partially pre-funded system means—dividing those accumulating assets into millions of personal accounts could be the safest device for doing so.

One last argument frequently made for personal accounts is that they would involve Americans more directly in planning for their own futures. The need to decide whether to start a personal account, how much to put in it, and where to invest it would not only introduce many to the satisfactions of saving and investing, but would make all more conscious of the adequacy or inadequacy of their resources. More saving might follow, with benefits both for individuals and the nation.

A defining promise

President Bush has called Social Security “the single most successful government program in America history” and “a defining American promise.”

That positive view of the program's past and future is not only the spirit best designed to advance the cause of reform, but the most accurate view of the matter as well.

America was not a wealthy-enough society in the 1930s to do what President Bush and conservative reformers now propose. It was not then wealthy enough to provide an adequate retirement to those already old while workers simultaneously set aside resources for their own retirements. So past generations, with what might be seen as characteristic American optimism, placed a bet on a more prosperous future, in which later generations would be able to support their elders while also improving their own condition.

That wager has paid off. Today, America is vastly richer, thanks largely to the work and creativity of previous generations. Today's Americans can afford to adapt to unforeseen demographic changes. Without renegeing on promises to today's elderly, they can reduce burdens on future generations and transform Social Security into something more like a “social...mechanism whereby the individual could...prevent dependency through his own efforts.” That is not a retreat from the program's defining promise but a completion of the original “idea of social security.”

What is needed now is the political courage to press the debate. ■