Social Security's War on Families

A Current Crisis and a Coming Disaster

by Doug Bandow

The war in Iraq has left many casualties; Social Security reform is one of them. For so long, Democrats surrounded the issue with demagoguery. And now that the Democrats control Capitol Hill, Republicans seem unwilling to acknowledge, let alone confront, Social Security's impending financial collapse.

And yet the need to confront the problem has never been greater. The coming retirement of roughly 78 million baby boomers threatens to wreck the U.S. Treasury and, perhaps, the economy. Social Security spent $461 billion last year, which made it the largest domestic outlay and a rival of the military budget for biggest federal expense overall. Despite the efforts of the would-be empire builders, who would like to devote the entire U.S. economy to the military, outlays for Social Security will eventually exceed defense spending. (At $406 billion last year, Medicare is gaining even faster and will soon outpace both the military and Social Security.) And Social Security is weakening more than the U.S. economy; it also undermines personal and family responsibility, encouraging early retirement and shifting the duty to care for the elderly to the government.

Social Security is built upon a lie. The system purports to maintain a trust fund, with "assets" of two trillion dollars in net present-value terms, which is supposed to cover benefits from 2017, when program outgo starts exceeding inflow, to 2041. This fund, however, is an accounting fiction. It contains no money; rather, it consists of a pile of federal paper IOUs that have no market value, in a file cabinet in a government office in West Virginia. Paying for benefits will require either tax hikes or spending cuts—the same as if there were no "trust fund."

The U.S. population is aging: Life expectancy is up; fertility rates are down. The number of elderly is growing, and the elderly are living longer. As a result, Social Security operates like a large-scale Ponzi scheme rather than an insurance system. One estimate (from the 2007 Trustees Report) concludes that, over the next 75 years, the program faces an unfunded liability of $6.8 trillion (in net present-value terms). Other estimates, which are highly sensitive to economic projections, run to nine trillion dollars or more.

Combine Social Security with Medicare, and you get a financial tsunami. Jagadeesh Gokhale, now at the Cato Institute, and Kent Smetters, a professor at the University of Pennsylvania, propose a measure of Fiscal Imbalance (FI) with an infinite time horizon. Their 2003 FI estimate for Social Security was seven trillion dollars; today, that number would be higher. (Medicare was even worse, with an FI of $36.6 trillion. The rest of the federal government ran just $0.5 trillion.)

Unfortunately, the FI worsens over time. At $44.2 trillion in 2003, the combined FI is set to grow "by about $1.6 trillion per year to about $54 trillion by just 2008 unless corrective policies are implemented before then," explain Gokhale and Smetters. Long-term estimates obviously are sensitive to economic assumptions: The FI could be "only" $29 trillion if we are lucky, or $64 trillion if we are not. And these estimates do not include the cost of the new drug benefit, which had not been passed when Gokhale and Smetters completed their analysis. That program adds somewhere in the neighborhood of $18 trillion to Uncle Sam's unfunded liabilities.

To put this into perspective, the federal government spends less than $3 trillion per year; the entire public debt is $4.6 trillion; America's annual GDP is about $12 trillion; and Americans' total personal financial net worth is about $35 trillion. Comptroller General David M. Walker has warned: "The only thing the United States is able to do a little after 2040 is pay interest on massive and growing federal debt. The model blows up in the mid-2040s. What does that mean? Argentina."

Having created an enormous unfunded liability, the Social Security system exacerbates the financial burden by discouraging private savings, an important factor in spurring economic growth. By soaking up money ($642 billion in taxes collected last year), the federal government diverts income that otherwise could be invested in economically productive private activities; and, by promising retirement benefits, Social Security also makes private saving seem less necessary. The program's net impact is to diminish investment, economic productivity, and overall growth. It will be difficult enough to come up with as much as $80 trillion to pay future benefits without inadvertently slowing the economy.

The burgeoning fiscal crisis is reason enough for reform, but, no matter how you slice it, the necessary reforms will be unpleasant. The only way to reduce costs is to cut benefits; and the only way to preserve benefits is to raise taxes. Beneficiaries already receive an awful rate of return on their "investment." A combination of higher taxes and lower benefits would make the program an even worse deal.

Economist Martin Feldstein compares the average growth of real wages since 1960, which he considers to be a good proxy for Social Security's rate of return, to the real pretax return on nonfinancial corporate capital (essentially, profits plus net interest paid). The difference is alarming:

> Consider an employee who contributes $1,000 to Social Security at age 50 to buy benefits to be paid at age 75. With a 2.6 percent yield, the $1,000 grows to $1,900 af-

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ter the 25 years. In contrast, a yield of 9.3 percent would allow the individual to buy the same $1,900 retirement income for only $206. Thus, forcing individuals to use the unfunded system dramatically increases their cost of buying retirement income. In the example, a funded plan would permit the individual to buy the same retirement income with a 2.5 percent contribution instead of the 12 percent payroll tax. The 9.5 percent difference is a pure real tax for which the individual gets nothing in return.

Attempting to choose between benefit reductions and tax hikes is likely to trigger an ugly generational battle. Certainly, no young person should count on Social Security for his retirement.

The problem with Social Security is not merely fiscal, but cultural and social. Though Social Security is presented as helping lower-income people and the disadvantaged, the system works against the interests of women and minorities. The rules, developed for two-parent, single-earner households, penalize an ever-larger share of the population: single workers, dual-earner couples, and early divorcées. Groups with shorter life expectancies, such as African-Americans, receive less back in benefits. Although poor people receive a boost—the benefit calculation is modestly progressive—they also tend to die sooner than their wealthier neighbors, so they collect less overall.

Social Security encourages earlier retirement. A study by the National Center for Policy Analysis noted that the percentage of men over 65 who work has dropped by half, to about 20 percent, despite the fact that Americans are living longer. (Roughly, the percentage of women working has stayed constant.) Work participation fell as a larger percentage of men were covered by Social Security and as benefits rose to a larger share of their previous incomes.

Social Security also reduces the incentive to save for one's retirement. For instance, though Social Security recipients have long been told that they should not rely on the program as their sole source of retirement income—the system provides only 42.4 percent of the preretirement income of average workers—today, Social Security benefits account for more than 90 percent of retiree incomes for one quarter of America's elderly. Social Security provides more than half of the income of at least half of today's retirees.

The impact, though it is difficult to measure, is significant. Writes Michael Tanner of the Cato Institute:

> For example, Martin Feldstein of Harvard University and Anthony Pellechio of the National Bureau for Economic Research have found that households reduce their private savings by nearly one dollar for every dollar of the present value of expected future Social Security benefits. Other studies have put the amount of substitution somewhat lower but still indicate a substantial offset. Even two researchers for the Social Security Administration, Dean Leimer and David Richardson, have conceded that "a dollar of Social Security wealth substitutes for about three-fifths of a dollar of fungible assets."

Feldstein reviews the issue from another direction. For an average retiree today, Social Security "benefits replace more than 80 percent of peak preretirement after-tax income. Common sense and casual observation suggest that individuals who can expect such a high replacement rate will do little saving for their retirement." He found median financial assets per household do not provide more than six months of income. Assuming a one-to-one replacement of Social Security benefits for private wealth, Feldstein calculates that "the annual loss of real income would be 6.7 percent of the $9 trillion of Social Security wealth—an amount equal to $600 billion or 8 percent of total GDP." The actual lost savings almost certainly is less, but even a 50-percent replacement would yield a substantial economic hit.

Obviously, people can retire whenever they wish. However, it makes no sense for the government to encourage them to do so earlier than otherwise, especially when the system is financially unsound. By quitting work sooner, they will be less able to save for their own retirements and will more quickly be dependent on public pension benefits. Both factors increase the public's burden and decrease the beneficiary's independence.

Melanie Anderson

Social Security directly discourages employment in other ways. First, payroll taxes act as a direct levy on employment, discouraging job creation. All taxes affect behavior. However, payroll levies have a particularly pernicious economic impact, since they simultaneously raise the cost of an employee to his employer and reduce the benefits received by the employee in compensation for his work.

Feldstein describes the "distorting effect of this tax." For a typical family, he figures that Social Security "raises the total marginal tax rate to more than 40 percent and substantially exacerbates the distortions and waste caused by the income tax." Companies will hire fewer workers and, as a result, people will work less.

But there is more. In a recent study for the Cato Institute, Feldstein points out that

> The combination of the income tax and the payroll tax distorts not only the number of hours that individuals work but also other dimensions of labor supply like occupational choice, location, and effort. It also distorts the form in which compensation is taken, shifting taxable cash into untaxed fringe benefits, nicer working conditions, etc.

The employment effect creates a particularly perverse incentive for a government pension system funded through employment. Penalizing workers means that people will work and save less, and seek pension benefits sooner. Thus, there will be fewer workers to support current retirees. Since the principal reason Social Security is rapidly approaching collapse is the dramatic reduction in the ratio between workers and retirees—soon, there will be just two workers for every beneficiary—reducing that ratio even more by pushing more people out of the workforce makes no sense.

Social Security shifts the responsibility for caring for the elderly from individuals and families to the state, and, in most people's minds, turns government into the principal agent to guarantee one's retirement security. Recipients consider their benefits to be "earned," a genuine investment or form of insurance. In fact, the Supreme Court has declared that people have no legal right to their benefits; moreover, today's retirees have received far more than they have paid in.

Social Security is in desperate need of reform, and, given the disaster that looms ahead, we cannot settle for temporary palliatives. Middling tax hikes and benefit cuts would reduce the government's net financial obligations—but only by placing more of a burden on today's workers.

The program has also changed attitudes among adult children and other family members. Since retirees are eligible for Social Security, they seem less needing, and deserving, of family support. In fact, through payroll taxes, young workers are already helping to finance their retired elders. And many of them are aware of the fact that the rising Social Security tax burden makes it harder for them to put money aside for themselves.

Indeed, Social Security, by dramatically lowering the rate of return on this form of "forced savings," makes two generations more dependent on government. Tanner notes that

> Social Security's rate of return has been steadily declining since the program's inception and is now far lower than the return on private capital investment. According to the Social Security Administration, workers born after 1973 will receive rates of return ranging from 3.7 percent for a low-wage, single-income couple to just 0.4 percent for a high-wage-earning single male.

Some studies have found that, for those born in this century, the average rate of return is falling to one percent—and below zero for some workers. They are actually losing money.

From 1926 to today, the average annual rate of return of the U.S. stock market is 7.7 percent. That includes the Great Depression, multiple recessions, and wars. Tanner points out that the average annual real return on corporate bonds (a much safer investment) is over four percent.

The numbers are astounding. According to Tanner,

> A single-earner couple, whose wage earner is 30 years old in 2000 and earning $24,000 per year, can expect to pay more than $134,000 in Social Security taxes over their lifetimes and receive $292,320 in lifetime Social Security benefits (including spousal benefits), assuming that both husband and wife live to normally expected ages. However, had they been able to invest privately, they would have received $875,280. That means the current Social Security system is depriving them of more than half a million dollars.

Transferring responsibility for the care of the elderly has had significant, deleterious social consequences. Caring for different generations within a family can be difficult. Yet the care of one's parents and relatives is a moral necessity, no matter how unpleasant. Social Security allows adult children to pretend that government has magically eliminated the financial pressures and psychological challenges of dealing with aging relatives.

Intergenerational ties bind communities together. Social Security weakens these links and makes it hard for a family to offer better care for its more vulnerable members. Across the generations, the family may provide imperfect care, but it offers a mix of love and knowledge that is, by definition, lacking in any public program. And it discourages the extra effort that characterizes family relationships.

Thomas Jefferson argued that "Dependence begets subservience and venality." Tanner puts it just as provocatively: "In essence, it reduces American seniors to supplicants, robbing them of their dignity and control over their own lives."

Social Security is in desperate need of reform, and, given the damage that is being done already and the disaster that looms ahead, we cannot settle for temporary palliatives. Middling tax hikes and benefit cuts would reduce the government's net financial obligations—but only by placing more of a burden on today's workers. Such a solution does nothing to counteract the program's dependency-inducing characteristics.

The best approach would be to establish some form of private accounts, turning both the resources and the responsibility for retirement over to retirees themselves. As Tanner puts it, "Instead of saving Social Security, we should begin the transition to a new and better retirement system based on individually owned, privately invested accounts."

The economic benefits would be huge. "Conservative assumptions," Martin Feldstein writes,

> imply that Social Security privatization would increase the economic well-being of future generations by an amount equal to 5 percent of GDP each year as long as the system lasts. Although the transition to a funded system would involve economic as well as political costs, the net present value of the gain would be enormous—as much as $10-20 trillion.

Such a gain would dramatically enhance the ability of families to care for one another—a moral benefit that outweighs even the considerable economic benefits of throwing off the shackles of government.

A Humble Love

by Derek Turner

"Not only England, but every Englishman is an island."
—Friedrich von Hardenberg

Melanie Anderson

Betjeman: A Life
by A.N. Wilson
London: Hutchinson Press;
375 pp., $27.00

John Betjeman's evocative and educative television programs and his uniquely readable poetry have left an indelible image in the British public mind—of a jolly, witty, and eccentric man, ambling around Britain's cities and countryside, pointing out hitherto unnoticed details of hitherto underappreciated buildings and excoriating the dreadful devastation caused by town planners for whom anything old was axiomatically inferior. Betjeman's frequent media appearances, with his trademark crumpled mac, battered hat, and plastic bag; his confessional interviews and articles; his patent kindliness; and his ability to laugh at himself left many Britons with the impression that they knew Betjeman personally. He was a kind of national favorite uncle (albeit one with teeth infamously "covered in green slime" and a "pong" caused by his dislike of bathing).

The publication of Andrew Norman Wilson's long-anticipated biography of this popular figure was overshadowed by the revelation that rival biographer Bevis Hillier had hoaxed Wilson into including a love-letter purportedly written by Betjeman. The letter was cleverly written—but, taken together, the capital letters at the beginning of each of the sentences spelled out "A N Wilson is a shit," and it was forwarded by "Eve de Harben," an anagram for "Ever been had." Hillier resented Wilson for calling the second volume of Hillier's three-volume, 25-years-in-the-making Betjeman biography a "hopeless mish-mash"—and because Wilson's biography had received prepublication publicity as "the big one." Wilson has apparently retaliated in his own hastily produced second edition, but that covert message has yet to be revealed.

Wilson has previously written books about Jesus, Saint Paul, Belloc, C.S. Lewis, Milton, Tolstoy, Scott, the Victorians, London, and the House of Windsor, as well as some 19 novels. He also writes regular columns for newspapers. His biography of Iris Murdoch (2003) drew critical venom, with reviewers calling it, variously, "the aborted foetus of the biography he was contracted to write, pickled in a disturbing mixture of regret, nostalgia and distaste"; "a nasty, hasty piece of work, pockmarked with gratuitous insults, unprovable anecdotes and cruel asides"; and "misguided, treacherous and inessential." One critic noted, "[Wilson] seems to thrive on . . . negative energy: the radioactive fission of feud and betrayal." Mercifully, he is also capable of making deft character judgments, and of viewing Betjeman in his true colors and context.

Betjeman was born into a middle-class family in north London. His father was the proprietor of a third-generation, high-end furniture-making business founded by Anglo-German forebears in the 18th century. They were never close, although Betjeman recorded that his father had read Goldsmith's *Deserted Village* to him as a boy, with considerable formative effect. Betjeman's refusal to follow his father into the family firm ("Uninteresting then it seemed to me, / Uninteresting still") was a source of friction and of lifelong guilt for Betjeman. In his 1960 blank-verse autobiography *Summoned by Bells*, he was still dwelling on his father's reaction:

I see his kind grey eyes look woundedly at mine,
I see his workmen getting other jobs,
And that red granite obelisk that marks
The family grave in Highgate Cemetery
Points an accusing finger to the sky.

His childhood was characterized by acute consciousness of his middle-class (and, to a lesser extent, partly non-English)

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