

## CATO INSTITUTE POLICY FORUM

SOCIAL SECURITY: IS IT A CRISIS THAT DOESN'T EXIST?

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## Featuring:

Andrew G. Biggs, Social Security Analyst, Cato Institute;  
Dean Baker, Coauthor, "Social Security: The Phony Crisis";  
Richard Jackson, Senior Advisor, The Concord Coalition; and  
Eugene Steurle, Senior Fellow, The Urban Institute

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## P R O C E E D I N G S

MR. TANNER: We're going to go ahead and get started. My name is Michael Tanner, and I'm Director of Health and Welfare Studies at the Cato Institute and also Director of the Cato Institute Project on Social Security Privatization.

It's my pleasure today to welcome you to our version of the great debate. I actually hope that you will get more light out of this coming debate than the one we just heard on TV and the one that we can expect tonight. I think this will actually be a good debate. Although I will have to say that, in honor of Al Gore, I was actually there with FDR when he signed the Social Security Bill.

(Laughter.)

MR. TANNER: Sorry, let's let certain things slide.

At any rate, we are very fortunate to have this debate here today. Every spring in Washington, we go through an exercise where the Social Security trustees release their annual report on the state of the Social Security system, and it projects how many years before the system runs a deficit and how many years before the trust fund is exhausted, and so on. And every year the partisans on both sides of the Social Security

privatization debate take this report and point out various aspects of it.

Those who support Social Security privatization point out how few years it is until the system runs its deficit. It's now scheduled for 2015. And the fact that by 2037, the trust fund will be exhausted, and so on. And, opponents point out that, well, you've got till 2037, if you count the trust fund as real assets and that you can change it this way or that way and solve the problem.

But there seems to have been, until recently, sort of a consensus on accepting the numbers of the Social Security trustees, and saying that their intermediate assumptions would be the basis for all this debate and that when we talked about the survival of Social Security there really was a problem; there really was a coming financial crisis; Social Security really was going to be running a deficit and eventually be insolvent.

That has been challenged recently by a number of people, including one of our guests here, who I think really has led the movement to challenge that assumption, Dean Baker, who, with Mark Weisbrot, wrote their book "The Phony Crisis." And I think that that book really was the loadstone of the movement to challenge this wisdom and to suggest that there really is no Social Security crisis; that if we just have a little more

economic growth or even the amount of the economic growth that we've had in the past, Social Security will be just fine.

I have to say that those on the left who have projected this have been joined by some people on the right, in the pages of the Wall Street Journal and among some supply-siders, who have also argued that if we just cut marginal tax rates, therefore we will have enough revenue in the future to solve all of Social Security's problems, so we don't really need to worry about it.

Today we're going to talk about whether or not that view is right: Is there a Social Security crisis or is it a crisis that doesn't exist? Our first speaker on that has just released a Cato paper, which will be available for you as you leave -- it's being delivered as we speak, so you'll be able to pick it up on your way out, but I'm sure he'll give a tremendous summary of it. That is Andrew Biggs, who is the Social Security Analyst with Cato's Project on Social Security Privatization.

That doesn't begin to describe his duties. He's actually the de facto deputy director of the project, the man who makes most of the day-to-day things on the project happen. He is a former staff member for the House Banking and Financial Services Committee. He holds a bachelor's degree from Queen's University of Belfast, his master's from Cambridge University, and a Ph.D. in economics from the London School of Economics.

He is also the editor of Cato's weekly newsletter on Social Security privatization, and he has produced a new paper, called "Social Security: Is it a Crisis that Doesn't Exist?" And he'll provide his viewpoint on that right now.

Andrew.

ANDREW G. BIGGS,  
SOCIAL SECURITY ANALYST, CATO INSTITUTE

MR. BIGGS: Thanks very much, Mike. And thank you all for coming. I would like to ask our guests for coming, as well. I think we should have a very interesting debate here today.

In 1998, President Clinton took part in a nationwide series of town hall meetings on Social Security reform. At these meetings, co-sponsored by the Concord Coalition and the AARP, Clinton urged steps to "ensure strong retirement benefits for the baby-boom generation without placing undue burden on our children and grandchildren." There is vigorous debate on the best type of reform for Social Security but most agreed with the President that in these good economic times we should fix the roof while the sun is shining.

But, two years later, many people are asking whether the Social Security roof even needs fixing or whether the rain will ever come. These crisis deniers argue that Social

Security's problems are simply the product of pessimistic economic assumptions made by the program's trustees.

If the economy's growth exceeds the 1.7 percent annual rate predicted by the trustees, as the crisis deniers believe it surely will, then wages will rise, payroll tax revenues will increase, and Social Security will become, in the words of New York Democratic Congressman Jerrold Nadler, a crisis that doesn't exist.

Financial columnist Jane Bryant Quinn agrees. In 1998 she said, "We can't drag our feet any longer on Social Security reform." But today she calls herself "the only kid in the village who's not crying wolf on Social Security."

Likewise, Business Week calls the trustees' growth projections ridiculously low and Social Security itself a phony conflict over a phony problem. Green Party Presidential candidate Ralph Nader rejects the very premise of a Social Security crisis. And even Vice President Gore has gotten on the band wagon. Gore says, "If Social Security ain't broke, why fix it?" And the plan he has offered does just that. It doesn't fix it.

These crisis deniers make three central arguments. First, that the trustees' projections of Social Security insolvency are based on highly pessimistic estimates of future economic growth; second, that more realistic rates of economic

growth will return the system to health; and, third, that even if the trustees' projections turn out to be true and Social Security does begin running deficits, these are easily affordable.

The first of these claims appears logical. After all, the trustees project economic growth for the next 75 years at just half the average since 1960. But in this debate, too much emphasis is put on the simple GDP growth number, which in fact has practically nothing to do with Social Security itself. Too little attention is paid to the variables of wage growth and labor force growth that lie behind the GDP number, and which help determine Social Security's future.

Contrary to some perceptions, the trustees don't project that American workers will suddenly become unproductive and the economy will grind to a halt. Rather, the trustees project low economic growth simply because there won't be enough new workers. Low birth rates since the 1970's mean that labor force growth will fall to just 0.2 percent annually, and slower growth of the labor force equals slower growth of the economy.

What the trustees don't project is slower growth of wages. In fact, the trustees' estimate of 1 percent annual wage growth is one-third higher than that over the past 30 years, and fully twice as high as from 1975 to 1995. In short, while the economy may grow more slowly in total, for each individual

worker, wages are projected to rise substantially more quickly than they have in recent decades.

Hence, while any projection is bound to contain errors, and somewhat higher wage growth is both possible and desirable, the trustees' forecasts appear at least reasonable in terms of the context of the past several decades. If so, then Social Security is looking at payroll tax deficits beginning in 2015, and a total long-term funding shortfall of 20 trillion in today's dollars.

Two independent assessments of the trustees' projections agreed. Accounting giant PriceWaterhouseCoopers found that the trustees' methods and assumptions both to be reasonable. And the 1999 technical panel on assumptions and methods, chaired by Dr. Steurle, concluded that the trustees' projections could be, if anything, optimistic regarding the program's future financing.

If the trustees underestimate future increases in life expectancies, as the technical panel concluded, then the retiree population would grow faster and Social Security's deficits could be up to one-quarter higher than currently projected. In short, the crisis that doesn't exist could turn out to be even worse than we thought.

Nevertheless, many argue that increased economic growth will save the day for Social Security. For instance, Dean Baker

and Mark Weisbrot assert that "Using any remotely realistic projection for the growth of wages in the economy, the Social Security system will be solvent into the stratosphere of America's science fiction future." Intuitively, this makes sense. Faster economic growth means higher wages, and higher wages mean more payroll taxes paid into the system.

But for Social Security to stay even technically solvent until 2075, real wages would have to grow at a rate of 2.9 percent annually. This is 3.7 times faster than over the past 30 years and fully 40 percent faster than even during the booming 1960's. When you consider that wage growth from 1995 to 1999 averaged just 2.7 percent, and that this was the highest five-year wage growth period since 1960, it seems clear that solvency into the science fiction future demands science fiction levels of economic growth.

And remember, it's just technically solvent. Because these numbers assume that the Social Security trust fund truly saves for the future, a contention that is denied by, among others, the Congressional Budget Office, the General Accounting Office, the Congressional Research Service, and the Clinton administration itself. In that case, higher economic growth would accomplish even less than these calculations imply.

In short, economic growth, by itself, is a false promise for Social Security. And the reason is simple. When

workers' wages rise and they pay more taxes into Social Security, they become entitled to more benefits out of Social Security when they retire. With most other government programs, increased economic growth is simply a windfall. Higher tax revenues make more money available for spending, but the program's obligations to the public do not increase.

When I pay more in income taxes to the government, the government is not obliged to spend more on defense or research or anything else the general revenues pay for. But when I pay more in payroll taxes, the government is obliged to pay me more in Social Security benefits when I retire. Social Security differs fundamentally in that wage growth increases both its assets and its liabilities, and in roughly equal proportions.

For this reason, the current system makes it extremely difficult to use economic growth to get ahead of the game. Hence, Social Security could aptly be described by the Red Queen of Louis Carroll's "Alice in Wonderland," who tells Alice that, "In this place, it takes all the running you can do just to keep in the same place."

All this said, the crisis skeptics insist that even if Social Security does become insolvent, maintaining full benefits is easily affordable. For instance, former Clinton administration National Economic Advisor Laura Tyson argues that, while over the long term a financing shortfall develops, it

amounts to less than 1 percent of gross domestic product over the next 75 years.

But this is like telling a 100-year-old man at death's door that he has nothing to worry about because his average age is only 50. Today, Social Security is running a surplus of almost 1 percent of GDP. But since today's surpluses are not saved, what matters is not Social Security's average deficits over the next 75 years, but its deficits at any particular point in time. And these deficits come very soon and grow very large very fast.

For instance, in the 10 years prior to the trust fund's official insolvency in 2037, Social Security faces payroll tax deficits averaging 1.7 percent of GDP. From 2066 to 2075, when children born today will retire, Social Security's shortfall averages 2.1 percent of GDP, more than double the figure Tyson quoted. And these deficits never fall and they never go away.

When payroll tax shortfalls begin in 2015, those deficits will have to be made up by either raising taxes or cutting other spending. The fact that so few people mention raising payroll taxes shows how unpopular it would be.

By 2020, Social Security payroll taxes would have to rise to 15 percent; by 2030, to 17.8 percent; and by 2075, to almost 20 percent. Not surprisingly, these tax rates may be difficult to sell to workers who must also pay State and Federal

income taxes and will likely be subject to higher payroll taxes for Medicare as well.

Alternately, we can cut other government spending to make room in the budget for Social Security. Some of the crisis skeptics argue that the room is there, but we should be realistic about what this means. Assuming that total Federal spending continues as a constant percentage of the economy, by 2025 non-Social Security spending would have to be cut by 6.3 percent in order to pay full benefits. By 2035, it will be 9.8 percent; and by 2075 almost 12 percent.

But spending on natural resources and the environment is just 1.4 percent of the current budget; on transportation, just 2.5 percent; on education, training, employment, and social services combined, just 3.3 percent. We would have to eliminate all these programs and many, many more just to keep Social Security afloat over the long run. The thought occurs that if I were one of the Republican revolutionaries elected in 1994, with the desire to cut entire cabinet departments, the easiest way to do that might be to promise to pay full Social Security benefits forever without raising taxes.

Now, perhaps these and other programs can be reduced or eliminated without harming the public interest. Many here at the Cato Institute would surely argue that they can. But that view is not generally shared by those who deny Social Security's

problems. Regardless if we retain the current system while promising not to raise taxes, then Americans should be prepared for the spending cuts that inevitably lies ahead.

In conclusion, the Social Security crisis is coming, and it could turn out to be even worse than projected. While higher economic growth would be welcome, no growth rate within realistic parameters is sufficient to solve the problem for the long term. And when the problem comes, it will impose a substantial burden on future workers, particularly when they must also bear the other costs associated with an aging population.

Given all this, what is the solution? There is no easy one. But the key is to devise reforms of the system that can take advantage of higher economic growth, and to take the steps necessary to ensure that that higher economic growth actually takes place. After all, all future benefits must be paid for out of future economic output, regardless of the pension system in place.

Reform based on personal retirement accounts would be a start, particularly if they invested the payroll tax surpluses that have previously been used to buttress current government spending. Saving these surpluses would build assets for the future, but the system's benefit liabilities would rise only at the rate of the system's capacity to pay them. In this way, you could help close Social Security's financing gap.

Today's vibrant economy is a good thing for Americans and for the Federal budget in general. But we should not let irrational exuberance regarding the benefits of today's economic growth cloud the need for far-reaching reform of the nation's public pension system.

Thank you.

(Applause.)

MR. TANNER: Thank you very much.

As I mentioned earlier, I think, that what Dean Baker, together with Mark Weisbrot, in their book, has really set the basis for the question of this debate today. They have been preeminent in arguing that there is no Social Security crisis, or that it is a phony crisis, so we're very happy to hear their side of the issue today.

Dean Baker is Co-Director of the Center for Economic Policy Research and, as we mentioned, co-author, with Mark Weisbrot, of "Social Security: The Phony Crisis." Formerly, he was Senior Research Fellow at the Preamble Center in Washington, D.C., and the Century Fund in New York, and before that Senior Economist at the Economic Policy Institute in Washington. He has his Ph.D. in economics from the University of Michigan.

Dean.

DEAN BAKER,  
COAUTHOR, "SOCIAL SECURITY: THE PHONY CRISIS"

MR. BAKER: Thanks. I appreciate the chance to speak here today.

I have to say I was very impressed when I got the paper. I don't think I've ever seen anyone devote so much effort to arguing against my viewpoint, even if not always accurately, but, in any case, I was impressed.

In terms of talking about the book, our main reason in writing this book was, more than anything, to call attention to what's in "this" book "The Social Security Trustees' Report." Because, in looking at this, we saw a national debate, a major national debate, on the Nation's most important social program that is dominated by misinformation. More than anything, what we wanted to do was tell people what is in these projections.

You hear people going around -- people in their twenties, thirties, forties, even fifties -- saying, "Social Security is not going to be there for me." Okay, well, you look at the book, you look at the book and let's say we go to sleep. We never did anything. We take every word in here as being absolutely true, and what does it tell it us? First off, we could pay every penny of scheduled benefits through the year

2037. Okay, that gets many of us through our date with our demise.

If you go beyond that, okay, 2038, 2039, 2040, the trust fund is depleted. What does the book tell us? It tells us we could still pay about 72 percent of scheduled benefits. What does that mean? In the year 2040 -- we've never done anything; the book is exactly right -- a typical retiree gets 10 percent more in inflation-adjusted dollars than a typical retiree does today. Is that what your 20-year-old means when he says, "There's going to be nothing there for me" 10 percent more than what their grandparents are living on now?

Carry it out further, to 2060, they will have 30 percent more. In inflation-adjusted dollars, 30 percent more than a typical retiree has today. That's right out of the book. That's not the debate we're having in this country. People are thinking that this thing is going belly up. Maybe in 10 years, maybe in 20 years, maybe in 30 years, but if we don't do something quickly, the thing's going belly up. That's not true. It's not true by this book. It's not true by any scenario I could think of. Okay, so that's step 1: Let's look at what the numbers actually say.

Okay, step 2: Do I think they're pessimistic? I think they're pessimistic. I think assuming that were going to have 1.5 percent productivity growth on average is a pessimistic

assumption. Why do I think that? If we look back -- and let's not take 30 years; we've had a relatively bad period from '73 on -- let's go back as far as we can. We're looking into the future, and none of us knows the future. You know, we're looking into the science fiction future, excuse me, 75 years. We don't know this. None of us predicted personal computers back in the 1960's, so I don't think our knowledge of things 40, 50, 60 years out has improved significantly. So, we are looking are into the science fiction future.

What can we say about it? Let's look at the last 50 years. What has the average productivity growth rate been? About 2.1, 2.2 percent. Okay, somewhere around there. What would be my best guess for the future? Write it down. I don't know. No one here knows. Let's just take our best guess from the past.

We can go further back. We don't have very good numbers, but if you go back before World War II, before the Depression -- you know, there's a debate about that, but most people put it around 2 percent. So put it around there. Does that solve the problem in the sense that the fund is solvent for the indefinite future? No. It puts it out to about 2043, 2044, 2045. To me, that's reasonably good.

Furthermore, what it means is we have more rapid wage growth. People will be richer in that period. So, I'm willing

to say that maybe we don't have this thing solvent for 75 years, but I actually, in this sense, have a fair bit of confidence in future Congresses, and future presidents, that they'll be at least as smart as we are and, if there is a shortfall, we could deal with it.

I'll get back to that in a second, but let me make one other point, because Andrew made this and it's made frequently, that we talk about this idea, "This assumes the trust fund." Well, I'm willing to give anyone either side on this issue. Either we have a trust fund or we don't. You can choose one or the other; you can't choose both.

Either we have a trust fund, in which case the debts owed to the trust fund could be treated like any pension fund -- you know, if they've accumulated 300 million in government bonds, no one says, "Well, how's the government going to pay that?" They assume that. Okay? It's a separate program. That's one option. We have the trust fund. It can run out of money, it can have a shortfall.

You don't want the trust fund? That's fine, too. It's a government program that's going to cost more money in the future. It never runs out of money. Okay, the prison system. That's going to cost more money, too. Does it run out of money? The military, that might cost more money, too. Does that run out of money? So, you have an option. I'm willing to have it either

way. I'll let other people set the terms of the debate, but whichever way you pick it, I'm going to hold you to it. So, I think it's very important to be consistent here.

Secondly, one other thing I want to get to, Andrew, and then I'll back to whether we have a crisis here. I'm always fascinated by this when we have this issue that the trustees' numbers might be too optimistic because people might actually live longer. I'm old-fashioned enough to think that's good news, that people might live longer.

And I understand that that increases the projected shortfall. But I think it's very important that we understand what that means. Say people were just being born today, people in their teens, twenties, they live much longer than me and that means that they have a longer retirement than me, and that's more expensive than mine, well, I haven't done anything wrong by them, that we've given them the means to live longer, okay?

And, frankly, I don't really think it makes a lot of sense for me to be telling kids who are just born today what age they should retire at, how much taxes they should be paying in their working lifetime, and how much benefits they should be getting at some point in the future. In other words, it's not a generational issue. That's a problem that each generation is going to have to deal with, in turn.

And one thing I can guarantee you: Whatever we do in the year 2000 -- or, we'll make it the next Congress, 2001 -- it's not still going to be in place 40, 50, 60 years from now. So, don't think that we're writing this down and they're going to be bound by it. They're not. They're going to do what makes sense for them.

And I don't know, and no one here knows, what will make sense for them. And if it really turns out to be the case that we've blessed them with such great technology and health that they're going to live much longer than us, that's wonderful. And I think they'll have to worry about how they deal with that in terms of supporting themselves in retirement.

Now let me get to the next point: What's a crisis? I hate to have arguments over semantics. And I think a lot of economics turns out to be something big is something small. So, I think it makes more sense to say "Let's compare it to something." And people are always yelling at me, "Why do you bring other things into the issue?" Well, you want to call it a crisis. Let's compare it to other things.

And, again, I'm an old-fashioned enough economist -- I haven't been in Washington long enough maybe -- but, in economics, what matters is after-tax wages, in the sense that that's what determines people's willingness to work; most

importantly, it's what determines people's living standards.  
What do you have after you pay your taxes?

And maybe I'm different from some other people here, but suppose everyone were as rich Bill Gates but they paid 90 percent of their income in taxes? That wouldn't bother me. Maybe it would bother them. We've done very well by them in my book, because they all have a lot more money after tax than we do. So, what I like to do is say, okay, Social Security is a crisis? Fine, it's a crisis. But, what are the big things that will affect after-tax income? And I have several overheads -- I realize they haven't had a chance to get them copied for this, but if I had them I would show you them to you, but I'll tell you what's on them.

If we look at the potential impact on people's after-tax income, we have to raise Social Security tax -- we have the number right here -- 1.89 percent. That will do it -- 1.89 percent, we raise their taxes. That makes it solvent through the 75-year period. Well, straightforward arithmetic, we will say it lowers their after-tax income by 2 percent.

Well, here are some other things I looked at. We have projections for health care cost growth. A lot of people -- I know Pete Peterson had a New York Times op ed, where he's going, "Oh, my God, look at Medicare, look at Social Security. This will be devastating." Well, it's driven by health care cost

expenses in the private sector. And I did projections on that. If we carried that through the year 2030 -- these are rapid health care cost growth projections that underlie a lot of these baby-boomer trouble issues -- then the impact on after-tax, after-health care income is 12 percentage points, six times the crisis of Social Security.

Let's take another issue. Inequality. Over the last two decades, most workers have seen no increase in the real wage, not because we haven't had productivity growth but because we've had an increase in inequality. It's all gone to people at the high end. If that continues over the next 30 years, the impact on after-tax income for a typical worker is going to be a reduction of about 20 percent in their take-home pay, 10 times the Social Security crisis.

One more factor: productivity growth. Again, I care about productivity growth, not so much because of how it affects the Social Security story, but it means we're richer. If we could just take the case, let's say there's five-tenths of a percentage point more rapid productivity growth, every four years we've fully covered the cost of the tax increase that would be needed to fund the system for 75 years. So, I care about after-tax income. That's what I learned in grad school. That's what most people care about: what's on the pay check at the end

of the day. We all complain about the taxes, but we care about what's on the paycheck.

Secondly, let's say we do care about taxes. This isn't the first time we've had to raise taxes. In my book, I point out several other cases. If we look at increases in expenditures -- and the taxes come some at the State, some at the Federal level as a share of GDP -- the increase for Social Security is actually relatively small compared to, say, the increase in military spending associated with the buildup of the Cold War. It was about 8 percentage points as a share of GDP.

Or, we could take the increase in education spending to pay for us baby boomers when we were in school. That was about two and a half percentage points as a share of GDP. The increase in spending on Medicare, from 1965, when it started, to the present is, again, about two and a half percentage points as a share of GDP. The Carter/Reagan military buildup, 1978 to 1986, that's about one and a half percentage points as a share of GDP.

And, let's go back. Social Security, 1960 to 1990, that was about 2 percentage points as a share of GDP. In fact, if you look back decade by decade, if we want to say we have a Social Security crisis today, we had a much worse one in the forties, the fifties, the sixties, and the seventies, because in each of those decades we had larger tax increases than what we're looking at in the future.

So, again, if you want to call that a crisis, fine, but we're seeing crises all the time. So, I don't think it's meaningful to say that every problem we might face at some point in the future, and maybe the very distant future, is a crisis. If that makes people feel good, that's okay.

One last thing I just want to say in terms of the honesty of the debate. I passed out, and I assume most of you picked it up, a letter that I had sent to Martin Feldstein. One of the points I've raised with the advocates of -- and I won't just say "privatization," because I've raised this with people in the Clinton administration, as well -- if you want to put Social Security money in the stock market, whether through individual accounts or whether collectively through the trust fund, you have to have a projection of stock market returns.

And I've been beating people's heads against the wall and saying, look, we have a lot of people spending a lot of time thinking about the projections here. They look at wage growth, labor force growth, birth rates, death rates. There's a lot of work on this. And what I say is if you're going to spend all this time deriving all these projections in the Social Security trustees' report, it makes sense to just put some time into the stock market projections.

And, what's been happening to date is people have said, well, what's the return we can anticipate in the stock market?

"The same in the future as in the past." And, again, as we heard from Andrew, the whole reason we're projecting we're going to have a problem is that we're assuming much slower economic growth in the future than in the past.

So, how do those two go together? Well, if we had returns, we'd at least be able to evaluate the argument. Now, stock returns aren't a mystery. They don't just drop from -- it's not just manna from heaven. Stock returns either come from capital gains or stock goes up in price, or dividend payments. There's nothing else there. Stock goes up in price or dividend payments.

Now, I challenge Martin Feldstein, as well as everyone else -- I've harassed the people here -- if there's someone who hasn't gotten a letter who considers themselves a participant in the debate, I'll send it to you. What I'm just saying is if you think you can get 7 percent returns in an economy that's growing 1.7 percent a year, in which profits are growing 1.7 percent a year, and you currently have price-to-earnings ratios of 30 to 1, which gives you a dividend yield of under 2 percent, show me how to do it. No one has.

It takes me about 20 minutes to produce those projections. I can't be that much smarter than Martin Feldstein. I think before we put trillions of dollars of workers' core retirement savings in the stock market, it shouldn't be too much

to ask that someone just take a half-hour and write down the projections that tell us how this makes sense. When we've seen that, I think we could talk about it seriously. Until then, I don't even consider that on the agenda.

I'll stop there. Thanks.

(Applause.)

MR. TANNER: Thank you, Dean. And I appreciate your coming into the lion's den to talk to us today. It's always appreciated.

Our next speaker has been in the lion's den many times, although on both sides of issues. And we're very happy to have him here today and particularly to talk to us about some of the assumptions that are going into this on all sides of the debate. Gene Steurle is a Senior Fellow at the Urban Institute, where he has been extensively involved in tax and budget policy, and particularly Social Security.

He has served in the Treasury Department under four different Presidents and was eventually appointed Deputy Assistant Secretary of the Treasurer for Tax Analysis. And, for our point of view, one of the most important things is he served as Chair of the 1999 Technical Panel on Assumptions and Methods for the Social Security Administration, which reviews the economic and demographic assumptions and the methods used to project the status of the Social Security trust fund.

He has also co-author, with John Bocha, of "Retooling Social Security for the 21st Century," which I think is one of the best books out there, something that I certainly refer to at least every week on this issue. We're very happy to have Gene with us.

Gene Steurle.

EUGENE STEURLE,  
SENIOR FELLOW, THE URBAN INSTITUTE

MR. STEURLE: Thank you for the nice introduction. I'm not sure actually whether I'm supposed to be the lion or the gladiator. I think maybe I'm somewhere in between. Maybe that's the worst of all. You get hit by the sword from one end and you get gnawed by the teeth of the lion on the other.

Social Security: Is it a crisis that doesn't exist? Well, there's something to be said on both sides. I guess, like several people here, I'm not sure that I like the term "crisis." I mean, of the issues that face us, I'm not sure that I'd put Social Security down as a crisis.

In fact, I often go to audiences and pose them the question about what do they think are our major economic problems or major problems facing our society, and a lot of people venture forth education and some people venture forth crime. A lot of

people mention child poverty as a crisis. They don't usually mention the fact that we're living longer and that we're getting health care as a crisis.

Social Security is sort of a budgetary phenomenon that results from the very particular way we've designed this program to grow over time in ways that we do not design most programs of government. So, it's a very particular budgetary type of issue that I'll try to get into in a little bit more in a moment.

It's sort of funny that when we think of budget crises, we tend to think about things like Social Security and Medicare, where things are actually getting better and better from year to year in terms of the benefits that we get. And in areas where I think, as a society, we really need to work on our problems, we say we don't have the budgetary wherewithal, partly because we've decided that these other areas might get this automatic growth.

There's another problem I have in the question of whether it's a crisis. And that's the question of whether, if there is a crisis or there is a problem, whether to define it really as a Social Security problem. And I think, once we go down that road, we get trapped into the type of debate, in some sense, that we have today, which is it gets narrowly focused on things like trust funds, which actually, if you read between both sides, you actually find out that neither side really likes the use of trust funds as a way to really measure what's going on.

I think most people recognize that we really want to know what's going on in the economy, how do we take care of older people in our economy, and will we have the means to deal with it. And trust funds are just very crude ways we have of trying to measure it. As I say, that's I think recognized on all sides of the debate, and certainly in Andrew's paper, as well.

What is this problem that's coming up? Well, it's largely centered or it's largely focused or it largely happens when the baby boomers retire, even though those who have studied demographics know that it's really not just a baby boom phenomenon. It's largely led by the fact that we have people retiring for very long periods of time and we have significant declines in birth rates. And those two together are leading to a very dramatic drop in the number of workers relevant to the number of scheduled retirees.

And that has all sorts of implications, one of which is that we are projecting, or at least Social Security projects now, that if we continue retiring at the rate we are now, and given that the birth rates of the past are largely dominating the labor force for the next 20 or 30 years -- even if we would suddenly change birth rates, it's not going to affect the labor force for another 25 or 30 years -- so we know pretty well what this dependency ratio is going to be. And it turns out that close to

a third of all adults in society are soon scheduled to be on Social Security.

That's a lot of society on Social Security. And it's not clear, relative to other needy people in society, that these are indeed the most important people that will be largely supported through a government transfer system. You can say that we can afford it. And I think actually Dean's right -- if the economy gets richer, we can afford it. We could afford a lot of things today that we couldn't have afforded in 1900, when we were only one-fifth as rich on a per capita basis. We could have tax rates of 60 or 70 or 80 percent today and still have money left over that makes us richer than people in 1900.

That doesn't mean, however, that that's what we want to do. Just because we're richer, that doesn't mean that that's how we want to divide our resources or the most important things we want to subsidize; as in this case, that a 17th or an 18th or a 19th year in retirement, that that has a higher priority than, say, child poverty or some of the problems in some of our central cities, crime, or anything else.

So, we have this large change in dependency ratios that is coming about. It has been reflected in the budget, in the fact that if you take a graph of Social Security, Medicare, and Medicaid, this is an approximation for spending on the elderly. It's the only 75-year approximation we have. It comes pretty

close. Medicaid has got some money that's not spent on the elderly, but then there's some other money spent on the elderly that's not in this projection. So, it's a rough approximation.

And if you take the numbers done by the Office of Management and Budget or the Congressional Budget Office and, under a variety of economic assumptions, a variety of economic growth rates, and it turns out that these programs that used to be 5 or 10 percent of total revenues now are getting close to 40 or so percent, and are growing up toward 80 or 90 percent of total revenues under these projections, leaving no money for almost anything else.

Can we afford it? Yes, we can afford it. But the question is: Do we want that type of society to occur?

Now, the question also comes about: Is this push that's coming about because of this 20th century decision to spend vastly increased portions of our societal wealth on retirement and health care in retirement, does the continuation of that reflect the demands of society?

I would argue that, in many ways, I don't think it does. And in large part, because we don't really vote on it. What's happening is that, again, going back to the way we design programs, it's the health in the retirement programs that have the automatic growth that we don't have in the education or -- what were the ones you mentioned, Dean -- the military, prisons.

You don't have automatic growth there. You vote on it from year to year.

It's not that if we have an older population in the future we might not spend more on the old. We may indeed spend more on the old. But we don't set it up in such a way that today we have determined that they get their money before the educators get their money, before the prisons get their money, or before, if you want to, the taxpayers get their money. That's a decision, in a democratic society it seems to me, we have to make over time.

To give you an example of this automatic growth, under current projections, at the modest productivity rates we now have, a typical couple retiring in the year 2000 gets a life-time benefit of about \$265,000. That's what they would pay if they went to insurance company today and said, "I want to buy a policy. What would you charge me for that policy?" It's about \$265,000.

The reason the number gets so large is that, for a typical couple, the longer living of the two will live 25 years, so that's about 25 years' worth of benefits. It's the main thing that's adding up to those costs. It's not so much that the annual benefit is so high.

By 2040, that number is projected to grow to \$435,000. So, under these modest economic growth rates, the number grows by

60 percent or so. So, one way to solve our crisis, if we wanted to do it, is we could say, let's not let that number grow by 60 percent; let's let it grow by 30 percent. And almost under all projections, the trust funds would be in balance. Now, that may not be the type of program that Cato would want in terms of, say, individual accounts or trying to put more saving in the system, as the Democrats in government also seem to want to do, by trying to build up a trust fund, but there seems to be some agreement on both sides to try and increase saving, and that dodges that issue. But if you just want to take what cash flow from the tax system is paying, you could easily give future retirees a lot more than they have today and solve the problem.

So, in that sense, Dean is right, there is not a crisis, because we can pay it off. But the problem remains that if this built-in growth is there and it's automatic, what are we usurping in terms of other things we want to have as a society? And it doesn't wait until 2037. It doesn't even wait until 2010 to happen. If you look at the budget today -- and, again, I'm going to add in health care; it's driven by health care until you get to about 2008 or so; and after that, it's retirement health care -- retirement and health care for the elderly are already pushing aside other parts of the budget. They are absorbing a larger and larger percent of total expenditures and total revenues every year, even today.

And if you follow the budget debates in Congress this year, last year, the year before that, and next year, you'll see that it is largely driven by this factor, this spending on the elderly. It has this automatic growth that tends to push aside other things, despite this temporary reprieve given from about 2002 to 2010.

Now, what did the technical panel that I served as Chair try to do? The technical panel's job was mainly to review the assumptions of the trustees, and largely came to the conclusion that they were fairly reasonable. We made some modest suggestions for change. Probably the principal thing that we suggested to change was that we said that life expectancy we thought was growing at a faster rate than the trustees were projecting.

And we used as examples not just some model building, but we noted that, under the Social Security projections, U.S. females would not attain the life expectancy of French females in 1995; that is, French females, in 1995, have a life expectancy that the Social Security trustees say American females would not achieve until 2033. It would take American females till 2049 to catch up to the life expectancy of Japanese females, in 1995. It was things like that led us to say that life expectancy projections probably should be increased.

Now, does that make it harder or easier to solve the problem? Actually, in my view, it made it easier to solve the problem when you went through all our projections. We said that we thought real economy growth would be higher. That was our one other projection. That made the actuary deficit a little bit smaller, if that's all you were going to focus on. My view is any reform of Social Security, even one that Dean will accept in the long run, is at some point going to index for life expectancy.

It's silly when President Clinton is announcing, in his State of the Union Address in 1998, that somebody born in that year might live to the year 2100. It's silly to think that somebody who is going to live to 102 should have a transfer system that's going to support him or her when they retire at 62, which would imply that they would have 40 years of transfers from other parts of the population to support them in retirement. To me that's silly.

Any reform is probably going to at least add indexing, whether the reform tries to maintain the current system or the reform tries to add on individual accounts. Once you accept that notion, that at some level we're going to index for life expectancy, we're going to build in some extent to which we say okay, you've got 18 years or 19 years or 20 years of retirement, we're not going to give you more than that, we're going to try to

keep it constant at some level, once that builds into the reform, it's easier to reform because the actual deficit that we would have projected under our system would have been less.

But let me add this. Between the trustees' report, the trustees' operation, the operation of this technical panel, these, for the most part are, I think, some of the best processes the government has. They really have a lot of checks and balances in them. I think they tend to be balanced. Our technical panel had Democrats and Republicans. I don't even know what they were, actually, in most cases. It was very nonpartisan. They were economists, actuaries, and demographers.

We agreed unanimously not as to the exact point of the estimate, but the general demeanor of the report. The trustees have a lot of checks and balances between private and public appointees to the system, as well as from the Actuary's Office, which I think is one of the finest in government. There are a lot of good checks and balances in this system. I think it would be a mistake to think of that system as being politicized, or try to politicize it in any way.

One of the issues that our panel also discussed that we tried to emphasize -- and it doesn't come out in the debate at all, is about what's the mean projection for what the system's going to be like in 2075, which, quite honestly, none of us really know very well -- is we tried to emphasize an issue that

in technical terms is called stochastic modeling. But the issue is you don't want to just look at the mean, you want to look at the variance. For instance, if you're thinking of investing in stocks, you don't want to just look at the mean return over time, you want to look at the riskiness of the stock.

Similarly, we want policymakers not to just look at some mean projection of values in the future, but we want them to look at the variance. We want them to look at how these things are going to vary over time. And the reason we want them to do that is because in fact it is possible to design the system so that this debate becomes superfluous. That is, I'll give you a big example: life expectancy. Maybe we got life expectancy right; maybe we didn't.

Index the system for life expectancy and it is no longer a system whose balance is affected by whether our projection is right or not. You just gradually, over time, increase a little bit the number of years of retirement that are -- excuse me, you increase the age at which early and normal retirement benefits are given, according to as people live longer, you promise something like 17 years or 15 years or whatever you think is the right number, that's the number of years of retirement we think we're going to give you. You gradually index the system. And the system no longer is risky according to that.

You could do it with respect to other parameters as well, although they're more complex. Which means this whole debate about whether somebody gets the number right or not could be put aside if we would just design the system so that if it is imbalanced in the future we have automatic mechanisms to take care of the problem.

Again, to take you back to the beginning, what makes this particular budgetary problem different from most other problems we talk about of government is that in the case of Social Security, and Medicare and our health programs in particular, is that they have a certain built-in indexing that almost no other program has. That indexing forces the government, forces the economy, forces the taxpayer to constantly devote larger and larger shares of national income out of revenues to these systems automatically.

Imagine if our Founding Fathers, in the year 1789, or whenever, had decided the budget for the year 2100. We would think that would be a bit silly. But if you look through the current system, because of these indexing factors and because they're built into the programs and there's no vote required every year, we have determined the budget, at least under current law, unless we change the law, for the year 2300.

It's that sort of arrogance in trying to totally predict the future and set a policy for the future that's causing

much of this problem. It's a budgetary problem. It's not a problem of having adequate resources to deal with many of the issues that face us as a nation.

Thank you.

(Applause.)

MR. TANNER: Thank you, Gene.

Our last speaker today has been here before, as well, and written for Cato. I think you have a copy of a paper that he co-authored with Neil Howe. Richard Jackson is a Senior Advisor to the Concord Coalition and an expert on entitlement programs in the federal budget. He's the co-author, as I mentioned, with Neil Howe, of Concord's series "Facing Facts: Reports on Social Security, Medicare, and the Budget," and the co-author, with Neil, of our paper there on "The Myth of the 2.2 Percent Solution."

We're very pleased to have you with us today to sum up. Richard Jackson.

RICHARD JACKSON,

SENIOR ADVISOR, THE CONCORD COALITION

MR. JACKSON: Thank you very much.

It seems just about everything has been said, but I guess I haven't had a chance to say it myself, so here goes.

I haven't seen an advance copy of Andrew's paper, so I can't vouch for all the details, but I would like to say that I am in agreement with the basic argument. It isn't pessimism to suppose that GDP growth, that the growth of the economy will slow in the future. It's simple arithmetic.

What the critics forget is of course that GDP growth depends on work force growth. And work force growth is projected to slow dramatically in the future. It has grown at about 1.7 percent since the early 1970's. It is projected to slow to about two-tenths of a percent by the 2020's. So it would fly in the face of all logic if GDP growth didn't slow.

Obviously, the more interesting question is whether the trustees are too pessimistic about productivity. Well, the Advisory Board Technical Panel that Gene headed up last year took a look at the issue and didn't really find much reason to think so. They recommended, I think, a .1 percent increase in the productivity growth rate, which actually the trustees incorporated into their 2000 reports.

As it turns out, the latest revision of the National Income and Product Accounts shows that productivity output per worker hour has grown at 1.4 percent since 1973. That's exactly now what the trustees' long-term productivity growth assumption is. Why since 1973, rather than going back further, as Dean suggested? Because in 1973, productivity dramatically slowed,

and the slow-down seemed to be persistent, and it occurred not just in the United States, it occurred in all developed countries.

Now, it's true that over the past couple of years, since 1996, productivity has picked up again and picked up dramatically. And maybe the trustees will have to raise their assumption again in the future in order to take that into account if it indeed turns out that this productivity slow-down is over.

But that brings me to my second point, and I guess it's the second point of agreement. And it also gets to the whole indexing issue you were talking about. And that's that even if the faster rate of productivity growth of the past few years turns out to be permanent, it isn't going to do a whole lot to improve the long-term outlook for Social Security.

And, again, this is ground that Andrew already went over but, yes, of course it's true that higher productivity means higher wages and that higher wages mean higher revenues. But higher wages also mean higher benefits. In fact, you really can't make substantial progress in solving the long-term financing gap in Social Security without de-linking wages from initial benefits. And I'm not sure if any my co-panelists support that. I'm not sure that that's something the Concord Coalition has advocated; I don't think so. But without such a reform, productivity just doesn't solve the long-term problem.

What about the other assumptions underlying the trustees' projections? Is there any closet pessimism there? Well, I don't think so on most of them; certainly not on fertility, which the trustees over the long run assume will be 1.95, which is the average rate over the past 25 years. Certainly not on immigration, where they posit a continuation of current trends.

Maybe the one area where they are a bit pessimistic, again, is longevity. But as we've seen, longevity would -- more optimism there would add to long-term costs, not reduce them. By the way, I wholeheartedly endorse the idea of indexing for longevity. I think that's a fundamental and an important reform.

Okay, so let's leave the assumptions aside and move on to the next issue, which is whether the official projections themselves are a cause for serious concern. I believe they are. This year, all Social Security benefits could be paid for with a payroll tax rate of 10.3 percent. By 2040, the trustees project that these benefits will cost 17.9 percent of payroll.

Is a cost increase of 75 percent affordable? Well, I suppose it is. Although hiking taxes to pay for those benefits ignores another big problem confronting Social Security, which is the declining rate of return on contributions. It does nothing to help that. As a matter of fact, it would make that worse.

Let me just comment briefly on Dean's argument on this issue. I actually find your argument about linking slower economic growth to declining returns in the future to be an intriguing one. I would just point out that we don't need returns of 7 percent real in the future to do better than what the current system promises. We need about 1 percent or 1.5 percent real. And we need less than that to do better than what the current system can pay after bankruptcy. And also I'm not quite sure how that fits in with the argument that we're underestimating economic growth and that that will speed up in the future. But that's another issue.

Also, of course, hiking taxes to pay for Social Security benefits ignores the issue Gene was talking about, which is the broader fiscal and economic context of an aging population and a graying budget. Remember, Social Security isn't the only senior benefit program whose cost is going to be rising. Add in both parts of Medicare and Medicaid -- here's the infamous New York Times ad -- and the projected burden rises to the equivalent of roughly 40 percent of each worker's taxable paycheck.

Now, defenders of the status quo really don't want to confront this cost in its totality. They would rather argue that each program is its own separate deal, a kind of hardened silo, regardless of whatever else is going on fiscally and economically. The idea seems to be that workers won't mind

paying a heavy tax burden so long as the money is being collected and distributed by different Federal agencies. But, let's be clear about one thing: If senior benefits are left on auto pilot, it will result in one of two outcomes: large tax hikes or the withering away of the rest of government.

I'm not sure if you were quoting the O&M numbers before. I think you were. But OMB now projects that by 2040 the big three senior programs -- I include Medicaid there because almost all of the projected growth is due to nursing home care for the elderly -- Social Security, both parts of Medicare, and Medicaid, will be consuming 81 percent of budget outlays according to the President's FY 2001 budget. That's up from 41 percent today and from 15 percent, I believe, in 1965.

I don't think anyone here really believes that the sole function of government should be to distribute benefits to old people, but that is the inevitable consequence, I submit, of adhering to two widely held and utterly contradictory goals. That is, not touching senior benefits and limiting the size of government.

So, that brings us to the second choice, which is raising taxes. And here Dean and I fundamentally agree. I'm not exactly sure what the differences in our assumptions are. But I've run the numbers myself and made a similar calculation to the one Dean has. And he is absolutely right that the growth in

Social Security itself doesn't put a big dent in after-tax worker wages in the future if we hike taxes to pay for it. It certainly doesn't if we only hike taxes 1.8 or 1.9 percent. But if we assume that we have to cover the cash deficits on a pay-as-you-go basis, that makes the slice out of after-tax wages a bit bigger. And if we include health care, it makes it a lot larger, still.

My basic assumptions are that the rest of the budget, the rest of outlays on non-senior programs remain constant as a share of GDP; that real per age-adjusted beneficiary spending on Medicare and Medicaid grows at half the real rate it has grown over the past 25 years; and that workers, that labor, bears the full incidence of payroll taxation.

And when my colleague, Neil Howe, and I cranked out those numbers, the result that we came to is that under the 1999 trustees' report, which is the last time we updated that, raising taxes to pay for the total cost of government would erase about four-fifths of the growth in after-tax wages over the next 50 years. So, I don't know if that's a crisis, but it certainly is a problem.

Thank you.

(Applause.)

MR. TANNER: Thank you very much.

We're going to get to you folks for your questions in just a minute, but since Andrew and Dean are sort of the heart of

this debate here, I'm going to offer each of them three minutes, if you will, to comment on what you've heard. We'll let Andrew go first and then Dean can sum it up, and then we'll go to you. So, if you just want to take three quick minutes.

MR. BIGGS: Sure. I could just comment for a moment on Dean's discussion of future stock returns. This is a big part of his book, and it is something I did bring up in my paper, although I did not make it really central to my comments, or I didn't even touch on it in my comments. I figured it would come up, so I just jotted down a few points.

The first is what Richard Jackson just said, that even if everything Dean says is correct and that stock returns in the future average 3.7 percent annually, well, Social Security's implicit rate of return is the sum of labor force growth and wage growth, and over the next 75 years that equals 1.37 percent annually. Now, would I rather have historical stock returns than 3.7 percent? Sure, but I'd rather have 3.7 percent than 1.4 percent.

Moreover, the point that Martin Feldstein makes is that the real return on a funded pension system is not simply the return on the investments it makes, but really the full real return on capital, which includes the returns on investments plus the extra corporate taxes that the companies you are investing in pay as a result of this extra investment. Now, this is only true

to the extent that the funding involves extra savings on top of what we're doing today, but certainly that's the intent of any funded pension system.

Now, the real return on capital over the past 40 years has been, on average, 5.6 percentage points higher than the implicit return on Social Security. So, if anything like that spread continues into the future, you still just have a difference in terms of what Social Security is returning and what a funded system will return.

Alternately, Dean excludes the possibility of investing overseas. But if a worker wants to invest overseas, I don't see any reason why they shouldn't be able to do that. Now, unless the stock returns in every country on the globe are going to fall, then I don't see, really, that this applies very much. This is one of those issues where it all looks very good in an all-other-things-being-equal sense, but often all other things aren't equal.

One empirical study I looked at, which was of 31 countries, done by a professor of finance at University of California, Irvine, found that, in practice, stock returns don't relate at all to GDP growth. What in fact they do relate to or correlate to is growth of GDP per capita. Now, growth of GDP per capita will not be as high in the future as it has been in the

past, but because it excludes the labor force issue, it will not be as low as the straight GDP number.

And just one final thing. If you look at the handout that Dean gave, which I would recommend you do look at, he gives decade-by-decade projections for what stocks will return, going from today, I believe, up until 2075. And in the process of that, I believe what he is projecting is taking the high stock market valuations today and, I believe, by the end of the 75-year period, they would be what he would consider properly valued.

Now, the problem is that's not really what Dean believes is going to happen. Dean has written that he thinks we're not going to see a gradual decline in stock prices. What we're going to see is a near-term correction -- or a very large correction. So, what you get then is something very different from what the chart he gives you shows, where you have low average returns over time.

But if you see a very large near-term correction in the stock market, well, then what you see is that the current investors would take a bath, but future investors investing in personal retirement accounts, or presumably if you were to invest the trust fund in stocks, would get something much more closer to historical rates of return. So, if you average it out over the long term, even then stocks give you a higher rate of return than Social Security.

But if you take into account that Dean thinks the market is going to crash very soon, or it's going to correct very soon, then you could see people in the future getting returns from stock investments substantially higher than what Social Security would pay. So, I think that's really the thing that I would focus on.

MR. TANNER: Dean, last word here.

MR. BAKER: Okay, a lot of stuff to cover. First off, let me just deal with that stock returns issue. The best thing we could do here is write it down. And I really can't understand the resistance of all the people who want us to put trillions of dollars of workers' core retirement savings in the stock market. Just write down the projections. We do it with everything else. Just write down. Capital gains and dividends; you don't like mine, give yours.

Now, that's true. I do think we're going to have a stock correction, a large plunge in value, but I wouldn't want to be out there making the argument: Put your money in the stock market today, don't worry, it'll crash, then you'll get a good return afterward. If you want to, be my guest.

A couple other things. There is a little bogus comparison here: returns on the stock market to returns in Social Security. We have a transition, folks, unless you're going to dump some people off and just say you're out of luck.

When you factor in that transition -- in other words, you have people paying taxes they are getting zero return on -- you factor that in -- and a number of people have done it, the Employees' Benefits Research Institute have done a number of good studies, and I don't know if they're Democrat or Republican, I don't know their politics -- they show the current system pays better returns than for people through the transition. Afterward, just like comparing renting to buying a home, once you've paid off your mortgage, yes, buying a home is better.

A couple of other quick things. Productivity growth. Arguing with the Social Security trustees is like arguing with the umpire -- you lose. But one thing you can do is say, "What did the umpire say last week?" Okay, back in 1996 the trustees' report said, "Real wage growth: 1 percent a year." There have been changes in the consumer price index. I've had the misfortune to have to follow that very closely. According to the Office of Management and Budget, the Council of Economic Advisors, and the Congressional Budget Office, those changes have summed to about seven-tenths of a percentage point a year. So, what that means is that if we had 1 percent wage growth projected in 1996, if we applied their number, it would be 1.7 going forward.

The productivity numbers, I think it's reasonable to use the last 50 years. I don't know whether the productivity

slowdown will continue and I don't know whether it won't. Clearly, the last four years would suggest otherwise. I'm not a believer in that. But what I will say is let's look to other countries. They've maintained 2 percent a year average productivity growth.

If we look at the OECD countries, it's not because they're poorer than us. By most measures, if you look at France, Belgium, Germany, the western part of Germany, they're about the same. So, if we think that we're going to maintain much lower productivity growth than the rest of Western Europe, and we're going to be a hell of a lot poorer than those nations, I'd be more concerned about that than we might have to raise taxes here a little.

A couple of other things. Health care, I don't know why it's sacrosanct. We can't do anything about our private sector health care system. I know that sounds bad here in Cato, but I'm just thinking, people care what comes out of their paycheck. I don't think they much feel better if it goes to the HMO rather than to the government. They care about what they have left over. So, I'd say we've got to do something about health care.

If you're going to give me a story that health care costs explode, then look at what it does to Medicare and Medicaid, granted, it's a big problem. Let's fix health care.

Every nation in the world gets by spending a much smaller share of their GDP on health care, and, as Gene was telling us, they have better health care statistics. I think we're doing something wrong here.

Okay, the last thing. It does worry me that these programs would grow as a share of the budget -- you know, Medicare, Social Security. The fact is this is done more efficiently through the public sector than the private. And I have plenty of evidence that can document that. I know that's painful for the people here at Cato. But the fact is that the total amount of money going to the government is not fixed.

I was very impressed -- the first time I was on a panel where someone brought this up they said, "Twenty percent of GDP goes to government revenue." I looked. It's close. Actually, if you go back 40 years, 50 years, it's about 19, and today it's about 21. But we'll say it's fixed. If you look back 40, 50 years, 5 percent of government revenue came from the payroll tax. Today it's about a third. So, in other words, we raised the payroll taxes as a share of government spending by close to about 30 percent.

Now, the question is: Is that something that was easy to do? No. Was it made easier by the fact that we told people, Don't worry, we're lowering the income tax, we're lowering the corporate income tax, two progressive taxes? I kind of doubt it.

So, in other words, I think this idea that somehow government spending is fixed as a share of GDP, I don't accept that. You're welcome to accept that, but let's just get the facts in front of the public and let them decide whether they'd be willing to pay more taxes for Social Security, for education, for other programs they value, rather than just telling them that this is fixed and that if these programs grow, you have to spend less on education and everything else.

MR. TANNER: All right. I think that sets it out about pretty plainly. I think you have, as George Bush would say, a difference of opinion.

Do we have any questions from the audience? We have a microphone. If you'll wait till the microphone gets to you -- because we record these and so that every one can hear you -- I would appreciate it.

MR. MAYER: Joe Mayer. My question is for Mr. Baker.

I understand that the motive of Cato in this debate, assuming that the crisis is phony. Cato is against government involvement no matter how successful, and that's fine. But what do you think is the motive of the business community in hyping this idea of a crisis in Social Security?

MR. BAKER: Well, I think it's mixed. You certainly have a lot of people in the business community who are, in general, conservative. They like to see small government. And,

certainly, if you could convince people that Social Security is a big problem and has to be cut back, that's not only something that might reduce the size of Social Security but also perhaps other government programs. And it's no secret that Social Security is sort of the core government program. It's the largest; it's the most popular.

So, if I were thinking from the other standpoint, that I wanted to cut back the size of government, I would want to cut back Social Security. There are some members of the business community who do stand to gain financially, potentially at least, if you, under certain privatization plans, funneled money into the financial markets. There are at least some segments of the financial sector that would do very well with that. And I'm sure they're aware of that. I don't think they're any worse than anyone else. But if people stand to gain perhaps billions of dollars in profits, I think that's going to affect their views on it to some extent.

MR. TANNER: Anyone else? We have another one down front.

MR. BOTHA: My name is Donald Botha. I'm on the retirement rolls.

And I'm surprised that nobody has even mentioned the possibility of killing a program that is basically broken. And that's obviously my opinion. But it was originally a security

blanket supported by somewhere in double digit by workers, and I understand that in the future it's going to be supported by far fewer. It provides a very good opportunity for politicians to say, "You and you and...", you know.

I'm not certain that I understood everything that's being said today. What if we merely abolished it and took it back to the place where it is a security blanket, an absolute minimum, and not something which, in my case, I live very nicely with the Social Security supplement for a professional salary, 50 years?

MR. BIGGS: Maybe I'll just touch on that a bit. I'm not sure I'd use the phrase "kill." These things tend not to go over very well. But we here at Cato, and obviously many other people, do favor returning Social Security, at least the government component of it, back to what it was intended to be -- social insurance.

When Social Security taxes were 2 percent of the first \$3,000 you earned, that seemed to be a reasonable price to pay for insurance. But when you're paying 12.5 percent of the first \$76,000 you earn, and then when that could go up to 18 or 20 percent, that's a pretty expensive insurance policy. So, what we would favor would be essentially a mandatory savings program based on personal accounts, like 401(k)'s or IRA's.

MALE VOICE: We would necessarily prefer it to be mandatory.

MR. BIGGS: Okay. Well, at this point.

In that sense, people would be providing for themselves insofar as possible. If you want to have a safety net, which would be an insurance component, then obviously that's a different issue. But you should be providing this only insofar as people cannot adequately provide for themselves. And so I think, in many ways, I do agree with you.

MR. STEURLE: Can I comment?

MR. TANNER: Sure.

MR. STEURLE: What you're raising here is an issue that's always referred to in technical terms as a very large transition problem. Essentially most people are, if I understand your circumstances correctly, most retirees are not in your circumstances.

For the vast majority of retirees, Social Security -- and if add Medicare in particular -- form two-thirds, three-quarters, nine-tenths of their retirement. So, it's only a small proportion of the population on Social Security that actually has significant other sources of income. And as this dependency ratio goes up, you do have this very difficult problem of how you go through a transition.

What you raise also is another interesting question, though. If we think of Social Security as providing a safety net -- in particular, say, a poverty-level benefit -- which actually, by the way, would, under current projections, given the number of retirees we're going to have, would take up a significant portion of even existing payroll tax -- but the interesting thing to me is the little focus that has been given to the design and structure of the Social Security benefit.

In particular, one of the largest transfer portions of Social Security is centered around what's called the spousal and survivors benefits, which were designed largely to ensure that women -- it was a stereotypical family that was used as the model in the days when Social Security was created -- the women who were not in the work force, it was created to specifically ensure that they would not suffer poverty in old age.

What has happened over the years now is that we have a very large number of women, for better or worse, who do not go into old age as spouses with enough years of marriage to qualify. So, this very large transfer component in Social Security is not available to a lot of women. In particular, a lot of these welfare mothers, for instance, we are putting to work are getting much, much lower returns on their contributions than are a lot of non-welfare, very wealthy women and men who are spouses and are able to have access to those other benefits.

So, if we want to get into the question of the design of a good poverty-level benefit, that is something that is very bothersome to me and it is very hard to actually get on the table. Because if we should be going back, then we should be asking the basic question: What do we want this system to do and is it doing it well? That should be the first question on our minds.

MR. TANNER: All right, I know we're standing between you and lunch, but we have time for about one or two more questions. I see one there and then one in the back.

MALE VOICE: I just had a question for Mr. Baker. When you said that you don't consider the current situation with Social Security a crisis because we've faced other crises in the past where we've been able to raise the money easily through taxation -- you mentioned the defense run-up in spending and the education of the baby boomers -- I would just point that both those investments have ancillary benefits that they create. If you invest in the defense industry, you create a lot of extra jobs. When you invest in education, you create productivity down the road. Giving retirees money doesn't create anything. It just creates a better lifestyle for retirees. There's no return on that investment.

And also, if you want to look at it as a political crisis, if one-third of all the voting-age adults in the United

States are going to be on Social Security rolls by 2040, I believe is what Mr. Steurle said -- I'm not sure of the year -- how are you going to wrest away their benefits when they're the ones putting the politicians in power?

I mean, what you're talking about there is a large number of people with an entrenched interest and nothing better to do than vote, and it's going to be very difficult to amend that system. And you said several times that future politicians would be able to amend that system. I don't know how that's going to be possible when you have such a massive amount of the voting public caught up in the Social Security system.

MR. TANNER: Two good questions, Dean.

MR. BAKER: Okay, you're assuming you want benefits cut. It'll be harder as you get more people dependent on it. We have lots of entrenched interests. A lot of them bother me a great deal. That's going to be one more. They're already there now; there will be more of them.

In terms of what are you getting for it. Well, people are getting, as we go along, more for it because they are living longer. That happens generation after generation after generation. The generation X-ers that whine "What about me," they need it more than I do. They, on average, are going to live longer than I do. So, they're getting more for it.

In terms of defense, by the way, the standard economic view is that defense diverts resources from productive uses; it doesn't add to them. And I'm actually very glad you raised that, because one of the things I should have mentioned is that we had a real big gift in the last decade. We had the end of the Cold War. Defense spending as a share of GDP fell by more 3 percentage points. That's more than anyone's scenario of the projected increase in Social Security spending.

Let me just spell that out as clearly as I can. Let's imagine the Cold War never ended. We would be worse off even we keep Social Security spending frozen exactly where it is for the indefinite future. We would still be worse off in that scenario than the one we're in now, where Cold War defense spending fell from over 6 percentage points of GDP to less than 3.

So we had this big gift. I don't think anyone expected it. At least I didn't see a lot of people predicting the end of the Cold War 10, 15 years ago. We had this big gift that has made us all better off as a nation. So that fully -- more than fully -- offsets the so-called crisis that we face by a projected increase in Social Security spending.

MALE VOICE: We already spent that money on elderly programs. Those 3 percentage points was mainly shifted to other programs already.

MR. BAKER: That's fine, but my point is in the world, we were making projections for that -- and, Gene, you were in on this -- you were making projections for this 10 years ago. We got a gift that wasn't anticipated.

MR. TANNER: If I can ask a follow-up -- and I appreciate your waiting for lunch just a little bit longer -- and then one last question that will come. I think the basis for the question was that since future benefits are going to have to be paid out of whatever the future economy generates, the best use of money is to try to grow the wealth so that we have more money available in the future with which to pay those benefits.

Since most government transfer programs are not investments in any sense and therefore do not add to economic growth in any way, isn't it better to have that money in the private sector, where it can be invested in new factories, equipment plants, educating people, or doing whatever it is that therefore will have a more economic growth and higher availability of funds in the future?

MR. BAKER: Well, I think that all of us think that people should have a core retirement income. And I know we have some people here who think it's better to have mandated savings. I don't see a big difference between mandated savings and a tax, and I think most people who see it come out of their paycheck probably wouldn't see it that way.

Now, the question in my mind is: Given that we think workers should have a core retirement income, there's a question of how large it should be, how small it should be, but given that we have that, how do we provide that in the most efficient way possible? And I would just refer to the fact that the expenses of operating the Social Security system are less than eight-tenths of a percent of the benefits paid out each year.

If you look at privatized systems, like the one in Chile -- and I'll take what gets paid in in benefits, because it's not a mature system -- the expenses of that system are about 15 percent of what gets paid in each year. I want this done in the most efficient way possible. I don't see any reason to have all this money going to the financial sector just because it might make some people here feel good to say that we have mandated savings and not taxes. That doesn't strike a chord with me. So I just say, let's do it as efficient as possible, and the Social Security system fits the bill.

MR. TANNER: Last question up there. Remember, people are going to be trampling you on the way out to lunch.

MR. MILIKAN: Al Milikan, Washington Independent Writers, for anyone.

What is the politics of referring to Social Security as a Ponzi scheme?

MALE VOICE: What is the politics?

MR. MILIKAN: Yes. I read that the Republicans, in the past, referred to it as that, and they're being ridiculed for that.

MALE VOICE: For my view on it, the Ponzi scheme analogy comes up quite a bit, which is not entirely accurate. I mean, a Ponzi scheme, a la Ponzi, can't go on forever. You get these compounding rates of return you'd have to get in order to pay everybody off, so, just mathematically, a Ponzi scheme can't go on forever.

Social Security can go on forever, but simply at the rate of return of the growth of the wage base. So, it's different in that sense. I think the Ponzi scheme analogy comes in with Social Security in that the first people into a Ponzi scheme get a very, very good deal, and that generates a lots of enthusiasm for the scheme. Now, the first people into Social Security also got a very, very good deal, and that generated a lot of enthusiasm for the program.

But when people look back and they say, "Well, my grandfather got this great deal from Social Security, it kept him out of poverty," well, the deal your grandfather got is not the deal you're going to get. And the impact on poverty for future seniors may not be nearly as beneficial as the impact on poverty in the past. So, I don't know if that touches on the Ponzi scheme politics, but I think, just for myself, the strict

mathematical comparison is not correct, but the psychological or the political comparison probably is.

MR. BAKER: If I could get a real quick line in. We should remember that Ponzi was a stock market manipulator. And, again, I keep asking for stock projections. And Andrew, I guess, agrees with me on this -- that if the market is hugely overvalued, it would have to fall by more than 50 percent to return to its historic valuations, that would destroy over 10 trillion in wealth. That comes to over 33,000 per person in this country. To me, that's a crisis that's far more serious than somewhere down the road we might have to raise the payroll tax a bit.

MALE VOICE: That would be exactly the moment to privatize the system.

MR. BAKER: You would have a good argument for it then.

MR. TANNER: So, we're all waiting for the coming stock market crash in order to privatize Social Security. On that note, please feel free to go upstairs. Thank you to our guests. I really appreciate it. Dean, thank you for coming and sharing with us. You can get a copy of Andrew's paper on your way out. I think you'll find it very interesting.

(Applause.)

(Whereupon, the Policy Forum was concluded.)