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Social Security—The Manufactured Crisis.

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President Bush recently declared that for Social Security, "the crisis is now," and once again called for a system of private accounts. But the real threat to Social Security comes from the Administration's own plans to use the panic it has created to slash benefits and reduce Social Security to a minor part of the nation's retirement system.

According to the Trustees of the Social Security Administration, widely regarded as the most authoritative source available, the system should be able to pay full benefits until 2042 when the trust fund runs dry in their intermediate projection.

That projection is very sensitive to assumptions about growth. The Trustees, acting in a fiduciary capacity, are appropriately pessimistic in their intermediate projection, but in a more optimistic scenario that is too rarely mentioned in the press, the system is projected to remain solvent indefinitely.

Even if the Social Security trust fund runs out in 2042, the system will not collapse (i.e., go bankrupt) because it will still be able to pay benefits that are higher in inflation-adjusted terms than the benefits currently awarded retirees. Although it is true they will be lower than scheduled, that is because benefits are indexed to wages, and are scheduled to go up as the nation's productivity rises.

The Bush Administration claims that the relevant day of reckoning is not 2042, but 2018, when the system begins to pay out more in benefits than it takes in through payroll taxes. But at that point, the government bonds that the trust fund holds will begin to play their intended role, providing debt service payments from the Treasury to finance some benefits.

These funds have been accumulated out of the surplus taxes that workers (chiefly in the Baby Boom generation) have been paying since 1983, when Congress, acting on the recommendations of the Greenspan Commission, raised payroll taxes. The often-repeated notion that these bonds don't count because they are not "real" assets borders on specious. By any reasonable accounting standard, the bonds held by the trust funds are real assets from the perspective of the Social Security program, because they are real liabilities for the Treasury. Finance textbooks tell us that the interest rate on Treasury bonds is "risk-free" because there is no credible danger of default.

Whether these funds have actually contributed anything to national saving or whether they were "raided" to finance the Reagan-Bush deficits is a separate, and hotly debated, issue. But servicing that debt should not call into question the benefits promised by Social Security.

Another factoid intended to arouse panic is that Social Security has over \$10 trillion in unfunded liabilities. That is the "open group infinite-horizon unfunded obligation" calculated by the Trustees. It represents the present value (i.e., corrected for the time value of money) of all future scheduled benefits minus all future taxes, from now until eternity. That's right, eternity.

Can such a big number mean very little? In the past, whenever the system has come close to insolvency, Congress has acted to restore balance by some combination of tax increases or benefit cuts, as was done with the 1983 Amendments. It is simply not credible to assume that Congress would fail to correct a fiscal imbalance indefinitely. And while \$10 trillion may sound like insolvency, it represents just over 1 percent of the gross domestic product over the same infinite horizon. Eternity is, after all, a very long time.

There are several plans circulating, such as one proposed by economists Peter Diamond from MIT and Peter Orszag from the Brookings Institution, that make modest changes in taxes and benefits to restore financial balance to Social Security. In contrast, the President's Commission to Strengthen Social Security has proposed cutting benefits (including returns from the new individual accounts) to about half their scheduled level for recent birth cohorts, mostly by eliminating the wage indexation of benefits.

The bottom line is that the system's financial status does not justify rushing the reforms that will be needed to fix it. Privatizing and cutting benefits would only turn the Administration's false alarm about the bankruptcy of the system into a self-fulfilling prophecy.