Social Security: A Call for Reform

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The history of the United States in the 20th century is marked by fluctuations in what Americans have expected from their national government. Economic and social changes have required the government to adapt its relationship with individuals. In the early part of the century, the federal government played a very small role in individuals' day-to-day lives. Large-scale social programs were non-existent. Individuals were seen as succeeding or failing based on their own abilities, with the threat of failure without a "safety-net" deemed necessary to encourage self-reliance and individual effort.1

The economic crisis of the late 1920s and 1930s and resulting social changes, altered the perception of the strict autonomy of individuals. The stock market crashed, banks failed, whole industries collapsed, and a large number of individuals, regardless of effort or ability, were left unemployed and destitute. The great economic and social dislocation of the Great Depression changed what Americans expected from their national government.

The constituency most affected by the Great Depression was the elderly. In 1935, less than 2.5 percent of the 6.5 million elderly had a private pension.2 The desperate state of the economy overburdened traditional institutions that had historically provided relief for seniors. Families, relief agencies, and private charities were unable to cope with the responsibility of caring for the elderly, many of whom could not care for themselves.

Policymakers opined that these circumstances "convinced the majority of the American people that individuals could not themselves provide adequately for their old age and that some sort of greater security should be provided by society."3 Social Security was considered the answer to this problem. In 1935, legislators initiated a program that would become the primary source of retirement security for the elderly. Social Security became the first large-scale social program that reflected a greatly increased role for the federal government in the everyday lives of Americans.

In the years since its inception, Social Security has been almost continuously expanded. The majority of the expansion took place in the 1950s and 1960s, when economics and conditions within society encouraged the active participation of the federal government in society. The government protected the United States from the Soviet Union with a strong national defense, passed and enforced civil rights legislation, promised "to end poverty as we know it," and paid for itself from the proceeds of explosive economic growth.

However, the economic and social conditions that encouraged active participation of the federal government in the lives of individuals have changed. The decreased economic growth and productivity of the 1970s and 1980s and increased inflation made it difficult for the government to generate revenue. Public confidence in the ability of their national government to solve the everyday problems of society has now eroded almost to the point of non-existence. Today, solutions proposed to address society's problems rarely emphasize an expanded role for government, but rather a diminishing role. No less authority than the president of the United States, and a Democrat at that, has called for the end of the era of "big government."
Social Security must be reformed...in such a way that the role of the government is reduced and the role of the individual is expanded in providing retirement income for the elderly.

And yet, Social Security remains wildly popular. Despite the fact that all experts agree that the current structure of Social Security is economically insupportable, altering Social Security is considered political suicide. This paper will explore the historical reasons for Social Security's economic vulnerability and widespread popularity. The analysis will also summarize Social Security's fiscal problems and analyze reforms proposed by the 1994-1996 Advisory Council on Social Security. Finally, in elaborating the dangers of delaying changes to the Social Security system, this paper will propose a strategy for Social Security reform that both reduces the role of government in the lives of individuals and makes Social Security more economically viable, while lessening the political dangers associated with reforming the system. Because of the size and prominence of Social Security, in order for the government to adapt itself to a new role in its relationship with individuals, Social Security must be reformed, and reformed in such a way that the role of the government is reduced and the role of the individual is expanded in providing retirement income for the elderly.

History of Social Security

Each decade since its inception, Social Security has been amended by policymakers to adapt the system to changes in economic or social conditions. All of the reforms undertaken from the 1930s to the 1970s expanded the Social Security system and significantly increased benefits for retirees. The reforms of the early 1980s were the first to decrease benefits and to address the growing problems the system faced because of adverse demographic and economic trends. Understanding the origins of Social Security and how it evolved in relation to changes in the economy and demographics, is important for understanding the system's popularity and fiscal vulnerability.

The Social Security Act, passed in 1935, was a response to the immense economic and social dislocation the Great Depression caused individuals, especially the elderly. The Act also sought to address long-term trends associated with the shift from an agrarian-based economy to an industrialized economy. Industrialization fundamentally changed institutions within society and, in the early 20th century, gave rise to constituencies, such as labor unions, business interests, and the elderly, that had not previously acted with any political cohesion.

The original Social Security Act introduced a new form of taxation, the payroll tax. With a payroll tax, the new system would be financed equally by contributory taxes from employers and employees. Tax revenues were to be accumulated for a period of several years and held in a trust fund, and beneficiaries would ultimately receive benefits from the taxes they had paid into the system. Benefits were initially set at a low level and only about 58 percent of workers qualified to participate in the new Social Security system.

The original design of the system is important for several reasons. The payroll tax would prove to be an effective tool for sustaining the popularity and viability of the Social Security system. As President Roosevelt predicted when he commented about funding Social Security with contributory taxes, "[W]e give contributors a legal, moral and political right to collect their pensions and unemployment benefits. With those taxes in there, no damn politician can ever scrap my social security program." The original design also gave the impression that workers paid into an individual account that would pay for their own benefits.

The original Social Security Act was amended in 1939. The changes made were to Social Security's method of financing. Initially, Social Security was designed as a fully-funded system, with taxes collected from workers accumulating in a reserve fund that would eventually pay for the same workers' benefits. The 1939 amendments, recommended by the first Advisory Council on Social Security and passed by Congress, changed the method of financing from the original reserve-funded system to a pay-as-you-go system. In a pay-as-you-go system, current payroll taxes cover the retirement benefits of current retirees. This creates a program that incurs "actuarial debt," or debt as obligations to current workers based on their expectations of benefits promised by the system when they reach retirement age.
These changes in Social Security were deemed necessary because of increased pressure by the elderly for more generous benefits and the fear that the reserve fund, then at $2 billion, was removing needed capital from the economy and promoting savings over consumption. Even in its formative years, Social Security was viewed as having an important impact on the economy and was responsive to pressures from constituent groups within society that desired to change the system.

Even with the initial reforms of the Social Security system, benefits paid to the elderly were still less than those of welfare programs. The 1948 Advisory Council subsequently recommended an expansion of Social Security benefits to remedy the elderly’s dependence on welfare. In 1950, Congress voted to increase Social Security benefits by 77 percent and to increase payroll taxes from one percent of $3,000 to three percent of $3,600. As a result of the changes made to Social Security in 1950, Social Security surpassed public welfare as the primary source of government income for the elderly.

Throughout the 1950s, Social Security benefits consistently increased and the extent of coverage was expanded to previously uncovered sectors of the workforce. The government was able to undertake these changes without raising taxes because of explosive economic growth and a favorable ratio of the number of workers to the number of beneficiaries. By increasing benefits and the extent of coverage without raising taxes, policymakers increased the popularity of Social Security. Individuals were asked to pay the same amount into the system and were promised greater benefits when they retired. Unfortunately, the government’s ability to accomplish this painless expansion was based on favorable economic and demographic trends, trends that would not remain favorable indefinitely.

In the 1960s, benefits continued to increase and health insurance, in the form of Medicare, was included for Social Security recipients. By the end of the 1960s, changes in demographics and the economy reduced the political expediency for the continued expansion of benefits for retirees. The economy was not growing as fast as it had in the 1950s and 1960s, and the ratio of workers to beneficiaries was declining. Because more people were now retiring at a higher benefit level and these new retirees had paid into the system longer, the real return on investment provided by Social Security was declining. At the same time, the cost of the system, measured as a percentage of taxable payroll, was increasing. As can be seen in Table 1, the government was spending more on Social Security and individuals were receiving less return on their investment.

The final period in Social Security’s evolution marked by substantial benefit increases was the indexing of benefits to inflation. Enacted in 1972 and implemented in 1975, indexing allowed benefits to increase without requiring politicians to vote on the size of the increases. Indexing benefits also gave retirees protection from erosion of their benefits by inflation.

The 1972 legislation required Social Security benefits to increase annually based on the Consumer Price Index (CPI), used by the Department of Labor to approximate increases in prices due to inflation. The CPI is not a measure of the cost of living, but rather a crude measure of price fluctuations. By tying Social Security increases to the CPI, Congress incorporated inaccuracies into the yearly increases. With the 1972 legislation, moreover, Congress removed Social Security increases from the realm of political debate and guaranteed expansion of the system into perpetuity. But the system’s financial problems also guaranteed that Social Security as a whole would not remain outside the political arena for long.

The history of the Social Security system from 1935 to 1972 is marked by consistent incremental expansion. Benefits were increased, but many of the increases were not accompanied by a subsequent rise in taxes. Significant growth in the economy during this nearly forty-year period made this policy economically feasible. However, after 1972, the downturn in the economy threatened to erode the benefit levels within the system. The pay-as-you-go financing method instituted in the 1939 reforms was vulnerable to fiscal instability due to the declining ratios of workers to beneficiaries, declining productivity in the economy, and increasing inflation.
The period from 1935-1972 is also marked by the perpetuation of several myths regarding Social Security that contributed to its popularity and have made it difficult to reform the system. These myths were: (1) that taxes paid by individuals were saved for their retirement; (2) that benefits could be increased without raising taxes; and (3) that by indexing benefits to inflation, Social Security benefits alone would adequately fund a comfortable retirement. The third myth may be the most damaging as it discourages individuals from saving for their own retirement. Although survey data holds that Americans know Social Security will not pay for all of their retirement needs, individuals' behavior contradicts these results. Americans do not save enough for their own retirement, and this is particularly true of the "baby-boomer" generation.

The Social Security reforms of 1983 sought to address some of the fiscal challenges facing the system. In the early 1980s, the Social Security system appeared not to be able to pay benefits to retirees. The legislative solution, suggested by a bi-partisan commission and passed by Congress, was a mixture of increased taxes and decreased benefits that restored Social Security's short-term financial stability. Some of the instruments used to achieve this stability included an increase in the payroll tax, a six-month delay in cost-of-living increases, expansion of coverage to new federal employees, and an increase in the amount benefits were taxable.

The reforms of 1983 can be considered a preview of future reforms if the system maintains its current structure. It is unlikely that the economy will grow sufficiently to increase revenues needed by the system, and demographic trends are unfavorable to the system's financial stability over the next 50 to 75 years. The fiscal stability of the pay-as-you-go structure of the current system can only be maintained by raising taxes, decreasing benefits, or a combination of both. The debate over Social Security has shifted from a question of "How, and how much do we increase benefits?" to "How can we maintain what we have?"

As Social Security has evolved, benefits—measured by real rate of return on investment—have decreased while costs—measured as a percentage of taxable payroll—have increased (see Table 1).

Moreover, throughout its evolution, changes to the Social Security system have followed recommendations of non-partisan commissions. In 1939 and 1950, the changes were recommended by the Advisory Council on Social Security and, in 1983, reforms were proposed by a bi-partisan commission created by President Reagan. This highlights the importance of non-partisan commissions to the continuing reform of Social Security and leads into an analysis of the reforms proposed by the 13-member Advisory Council on Social Security of 1994-1996.

**Table 1**

<table>
<thead>
<tr>
<th>Year</th>
<th>Benefit Average Real Rate of Return</th>
<th>Cost % of Taxable Payroll</th>
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<tbody>
<tr>
<td>1960</td>
<td>20%</td>
<td>5.89%</td>
</tr>
<tr>
<td>1970</td>
<td>10%</td>
<td>9.33%</td>
</tr>
<tr>
<td>1990</td>
<td>5%</td>
<td>13.16%</td>
</tr>
<tr>
<td>2020*</td>
<td>1-2%</td>
<td>20.04%</td>
</tr>
</tbody>
</table>

*Projected on intermediate economic and demographic assumptions and no changes in the system.


There is little question about whether Social Security needs to be reformed. The current structure of Social Security cannot maintain its obligations to beneficiaries. Although the system is now running a surplus, current assumptions concerning the economy and demographics project that this surplus will end in 2016, and that, between 2016 and 2029, the accumulated surplus in the system will be paid out. After 2029, payroll taxes will only provide about 76 percent of today's benefits to retirees. This impending fiscal shortfall has led to widespread recognition of the necessity for Social Security reform and to a proliferation of reform proposals.

The most prominent of the proposed reforms are the three plans advocated by the Advisory Council on Social Security.
Security, which met from 1994 to 1996 and released its report this year. Congress is likely to rely on the Advisory Council's recommendations for technical information and to provide a framework for legislation reforming Social Security.

The Council's report was noteworthy for three reasons: (1) the Council agreed on the financing problems faced by the current system; (2) the Council disagreed on legislative initiatives necessary to remedy this financing problem; and (3) the Council subsequently proposed three different reforms, all of which include some form of privatization. As the report indicates, the long-term financing problems facing Social Security are represented by a shortfall projected at 2.17 percent of taxable payroll over the next 75 years. In other words, if an increase in payroll taxes by only 1.09 percent on employers and employees was enacted today, Social Security would maintain financial stability through 2070. However, the Advisory Council on Social Security specifically rejected using tax increases alone to solve the long-term deficit.

The Council's three proposed reforms are the maintain benefits (MB) plan, the individual accounts (IA) plan, and the personal security account (PSA) plan. The MB plan would use incremental changes similar to those used in 1983 along with the investment of up to 40 percent of the Social Security Trust fund reserves in equity markets for higher investment returns. The IA plan would use incremental changes similar to those used in 1983 while increasing payroll taxes by 1.6 percent to fund individual investment accounts, which are invested in private markets and managed by the federal government. The final proposal, the PSA plan, would fundamentally change Social Security by mandating that five percent of employee payroll tax contributions be invested in the private market and managed by the individual. A more detailed look at these three plans is necessary to analyze their implications for changing the role of government in providing retirement benefits for the elderly.

The MB plan, supported by six members of the Advisory Council, would not alter the existing benefit structure and would remedy the majority of the existing shortfall in long-term financing by utilizing four of the five incremental reforms summarized in Table 2. The remaining shortfall would be covered by investing 40 percent of the Social Security Trust fund reserves, currently valued at approximately $500 billion, in private equities. The resulting increase in investment return, based on intermediate economic and demographic assumptions, would eliminate the remaining payroll deficit.

The incremental changes suggested by supporters of the MB plan include: (1) increased taxation of retiree's benefits; (2) extending Social Security coverage to state and local government workers; (3) adjusting the Consumer Price Index to more adequately reflect increases in inflation; and (4) increasing the period of work used to calculate benefits from 35 to 38 years. While this plan is called the "maintain benefits" plan, the four incremental changes would actually decrease benefits and increase taxes to maintain the system's financial stability. However, the proposed incremental reforms would maintain the fundamental structure of the system.

The investment of up to 40 percent of the Social Security trust fund reserves in private equities is a new approach.

<table>
<thead>
<tr>
<th>Policy Change</th>
<th>% Change in 75 yr. Deficit</th>
</tr>
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<tbody>
<tr>
<td>1. Adjusting the Consumer Price Index downward by .21%</td>
<td>-.31</td>
</tr>
<tr>
<td>2. Increasing taxes on benefits</td>
<td>-.31</td>
</tr>
<tr>
<td>3. Raising retirement age</td>
<td>-.5</td>
</tr>
<tr>
<td>4. Extending coverage to state and local government workers</td>
<td>-.22</td>
</tr>
<tr>
<td>5. Increasing work calculation from 35 to 38 years</td>
<td>-.28</td>
</tr>
<tr>
<td><strong>Total deficit reduction</strong>:</td>
<td><strong>-1.53</strong></td>
</tr>
<tr>
<td><strong>Remaining deficit</strong>:</td>
<td><strong>.64</strong></td>
</tr>
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</table>

*Total deficit reduction is not cumulative due to interrelationships between reforms.
designed to increase the return on investment. Historically, the Social Security Trust fund reserves has been invested in government securities that provide approximately 2.3 percent real return on investment. Advocates of the MB plan expect a real return of seven percent for the funds invested in private securities. Though this is the most conservative of the reform proposals, the MB plan still has a privatization component. While this privatization component represents a shift in the method for investing the Social Security Trust fund reserves, it does not signal a change in the role of government in providing income for retirees. Payroll taxes would still be collected from individuals in the same way as under the current system and the structure of benefits would be almost identical.

The IA plan, supported by two members of the Advisory Committee, would remedy the majority of the existing shortfall in long-term financing by implementing all five of the incremental changes summarized in Table 2. The IA plan would also decrease benefits by altering the benefit formula, resulting in an average decrease in benefits of 17 percent. To make up for this decrease in benefits, the plan would increase taxes on workers by 1.6 percent and the revenues from this tax increase would be used to fund individual accounts managed by the federal government.

The additional incremental change advocated by supporters of the IA plan is an increase in the normal retirement age. Currently, normal retirement age is scheduled to increase from 65 to 67 during the period from 2003 to 2011. The IA plan would continue to increase retirement age from 67 to 70 as indexed to increases in longevity. From the 1930s to the 1990s, the life expectancy for men increased by three years and women’s life expectancy increased by six years. Now, the life expectancy for both men and women is projected to increase three years by 2050. Advocates of the IA plan therefore recommend adjusting retirement age to compensate for these changes.

The establishment of individual accounts, financed by a 1.6 percent increase in payroll taxes, is a new approach that seeks to stimulate an increase in personal savings for retirement. Investment advisors and Social Security experts agree that individuals should save more for their own retirement. The IA plan would increase an individual’s stake in saving for retirement by presenting a set of investment options for workers to choose from, similar to options offered to current government workers for investing their pension funds. The investment options and revenues from the additional tax would be managed by the government.

Critics of the current Social Security system argue that the system discourages individual savings. This is a particularly important criticism as Social Security is only designed to be one of three sources for retirement income; personal savings and pension plans are supposed to provide the majority of income for individuals after retirement. Unfortunately, 66 percent of retirees depend on Social Security for over half their income. The IA plan seeks to address this criticism and shift more of the burden of saving for retirement to the individual.

While the IA plan is similar to the MB plan in its increased reliance on private markets for increased return on investment, the IA plan also adds a small facet of increased individual responsibility for choosing retirement investment options. However, because of the continued level of financing for “traditional” Social Security and the management of the investment program by the government, this option does not signal a change for the role of government in providing retirement income for the elderly.

The PSA plan, supported by five members of the Advisory Council, would incorporate three of the incremental changes summarized in Table 2 but would also fundamentally change the Social Security system. This fundamental change is based on a proposed shift of five percent of payroll taxes into investment accounts managed by individuals. The result would be a guaranteed benefit equal to approximately 47 percent of today’s benefits, with the remainder of the program’s retirement income provided by the annuitization of the investment account upon retirement. The large financial costs for transitioning to this new program would be funded by a 1.52 percent increase in payroll tax and $1.9 trillion in government debt. By shifting five percent of payroll taxes to private markets, advocates of the PSA plan hope to increase personal savings rates, increase individual responsibility for retirement, and increase growth in the economy by providing additional investment capital.

The large transition cost is necessary because current workers would have to pay current retirees and also pre-
fund their own retirement. Instead of promising current workers only future benefits, the PSA plan would pay them the half the benefits now and mandate that those benefits be saved for retirement. The result would be a two-tiered system. Current retirees would receive “traditional” Social Security and current workers would pay for this in addition to the new personal savings component. In the long term, the PSA plan gives Social Security much greater flexibility and financial stability, but also greatly increases the risk faced by individual investors. Poor investment decisions could cause individual retirees to rely on a reduced fixed benefit and increase their dependence on welfare.

While the PSA plan is similar to the MB and IA plans in that it increases the reliance on private markets for increased return on investment, it drastically alters the role of the individual within the Social Security system. Individuals would be responsible for managing a significant portion of their retirement income. The government’s role would shift from guarantor of all retirement benefits to guarantor of a minimum retirement benefit and regulator of private investment mandated within the new Social Security system. Individuals would be responsible for managing a significant portion of their retirement income. The government’s role would shift from guarantor of all retirement benefits to guarantor of a minimum retirement benefit and regulator of private investment mandated within the new Social Security system.

All three options proposed by the Advisory Council on Social Security would solve the projected shortfall of 2.17 percent of taxable payroll. However, none of the three proposals significantly reduce the role of the federal government in the everyday lives of Americans. The MB and IA plans maintain the current design of the Social Security system but also create a new role for government: investing Social Security funds in private markets. This is extremely dangerous as it gives the federal government the potential to further distort private markets. Interest groups, such as the environmental lobby, could pressure legislators to only allow investment in environmentally correct equities. Businesses would vie to be included in the government’s portfolio. The government’s role in a traditional bastion of individual independence would be expanded by this privatization component.

The PSA plan, while seeming to increase the role of the individual in saving for retirement, also has two major components that increase the role of the federal government in the lives of individuals. First, the PSA plan necessitates the raising of taxes by 1.52 percent and would incur $1.9 trillion in new government debt. The increased taxes and debt are a government subsidy to encourage private investment by individuals. Second, the role of government would increase through the regulation and control of the Personal Security Accounts mandated by the plan. Although the investment decisions of the account assets would be made by the individual, these accounts would be highly regulated by the government. A whole new bureaucracy would be required to handle this new structure.

How are legislators to design a reform that reduces the role of government in the lives of individuals, makes Social Security more economically viable, and lessens the political dangers associated with reforming the system? The answer to this question lies within the history of the expansion of Social Security and within the reform proposals of the Advisory Council. By incrementally reducing the Social Security system over an extended time frame and concurrently attacking the myths associated with the system through education, Social Security can be brought in line with the broader changes in the economy and changes in government’s relationship to individuals.

Alternative for Reforming Social Security

This paper’s proposal for reform utilizes the incremental reforms summarized in Table 2, but phases in the implementation of these reforms over a period of 30 years. The extended time frame for implementation spreads the burden of the reform over several generations, allows future retirees to adjust their behavior now in expectation of reduced future benefits, and allows time to educate all Americans about the myths of Social Security. Social Security was not built in a day, or even in one session of Congress so reforming the system needs to be approached
in a long-term fashion that some consider anathema to politicians. After 30 years, the Social Security system will be more economically viable, if greatly reduced in size, and individuals will be responsible for a greater portion of their economic well-being in retirement.

Of the reforms summarized in Table 2, increasing taxes on benefits, extending coverage to state and local government workers, and increasing benefit calculation from 35 to 38 years of work should be implemented immediately. Increasing taxes on benefits is the only systemic reform that is widely popular among workers and retirees. This is a result of another widely-held myth that the rich are using the proceeds of Social Security to pay for their country club memberships rather than using money from investments and private savings to fund a comfortable retirement. Extending the coverage to state and local government workers and increasing benefit calculation from 35 to 38 years of work are sufficiently technical and obscure to circumvent widespread opposition.

The final two reforms, however, will require phased implementation and significant education in order to be politically viable. These two reforms are adjusting downward the CPI calculations for Social Security and raising the retirement age. The CPI should be adjusted downward by 0.3 percent initially, and an additional 0.2 percent every five years for a period of 30 years. Retirement age should be increased using a schedule similar to those proposed by the IA and PSA plans. These are not popular initiatives and are currently opposed by a majority of workers and retirees. Advocating these reforms to the American people would require politicians to destroy some of the widely-held myths regarding Social Security and to challenge individuals to take a greater responsibility for their own retirement.

The advantages of phasing in implementation of these reforms over time are numerous. Gradual implementation would spare current retirees from bearing the brunt of a front-loaded reform. In contrast to the welfare reforms of 1996, in which whole segments of the population were removed from dependency over a short time-frame, the lowering of the CPI by 0.3 percent initially and 0.2 percent every five years for 30 years would have minimal impact on current retirees. Just as Social Security was gradually expanded from the 1930s to the 1970s, it would be gradually reduced with this proposed reform.

For current workers, the reductions can be marketed as a call to action. The government can educate individuals about the insufficiency of Social Security for replacement of pre-retirement income as well as the need for increased personal savings. The dual myths of the adequacy of Social Security and the ability to raise benefits without tax increases needs to be systematically attacked and destroyed.

Possibly the most difficult aspect of this plan is the necessary change in politicians’ rhetoric. Politicians are infamous for taking credit for social changes in which they play a very small part. Whether it is the creation of 11.5 million new jobs or the reduction of the welfare rolls, politicians trample each other in their efforts to claim personal credit or legitimacy for government programs they initiated in response to society’s problems. At the same time, they downplay the role of government in solving society’s problems. The hypocrisy of this rhetoric is debilitating to the public’s confidence in government.

The implementation of this reform plan will require an honest presentation to the American people because the plan shifts much of the responsibility for retirement from the government to the public. Without honesty, the plan will necessarily fail as individuals continue to believe that government will still be primarily responsible for their well-being in retirement.

**The Dangers of Delaying Social Security Reform**

The two most important dangers posed by delaying Social Security reform are political and economic. The size and universality of Social Security already distort the political and economic decisions of government, and this distortion will only grow more pronounced over time. Delaying Social Security reform decreases the potential for reforming the system in a way that is consistent with a necessary change in the role of government in society. Delay also decreases the ability of individuals to change their behav-
ior in expectation of changes to the system. If the system is not changed soon, more radical and more painful changes will be necessary later.

Social Security has almost reached the point of becoming self-perpetuating. Today, Social Security affects over 140 million people and its annual outlays account for roughly one-quarter of the revenues collected by the government. This growing monopoly over resources available to government is projected to increase through 2010 and then significantly increase when the “baby boomer” generation begins to retire. Social Security’s increased share of the budget will coincide with an increased percentage of voters receiving benefits.

With the current pay-as-you-go structure, managing the fiscal stability of the system will only become more difficult. Sustained economic growth, which would contribute to the system’s stability, cannot be controlled, legislated, or accurately predicted. Increasing taxes and decreasing benefits are both currently in political disfavor. The difficulty arises when decreasing benefits becomes even more politically impractical because of the number of voters receiving benefits.

This situation poses a problem for future decision makers. The current generation of government leaders has already mortgaged roughly 10-15 percent of the future budget to make payments on a $5 trillion national debt. They now need to make the decision of whether or not to make another 25-30 percent of the budget politically unassailable. Unless the size of the current pay-as-you-go system is reduced, the danger becomes a continued increase in the percentage of the budget unavailable to future legislators to use in response to economic recessions, changing national priorities or, in the extreme, threats to national security.

The reform of Social Security represents an opportunity to reshape the system, bringing it more into line with current changes in the perception of the appropriate role of government in society. By adopting a phased, incremental reform plan that emphasizes individual responsibility for retirement security, we can invest less in the potential for government and invest more in the potential of the individual. By changing the government’s role in providing income security for the elderly, we solve the fiscal problems government faces due to changing economics and demographics.

Social Security is the bell-weather in the debate over government reform. It enjoys this primacy because it was the first large-scale social insurance program and is the largest and most popular of these programs. But decisions about reform of the system must be made now. Delaying Social Security reform increases the economic cost of the reform and increases the political cost associated with changing the system. There is no need for further study of the issue. The future of Social Security is one of the most exhaustively documented subjects in public policy; sophisticated models have already been developed that analyze the impact of changes to the system. Policymakers have the information necessary to decide the future of Social Security.

Conclusion

Solving Social Security’s current financial difficulties should not be the long-term goal for reform. Meeting the projected shortfall of 2.17 percent of taxable payroll should only be the minimum. The only true way of protecting retirement income from vulnerability to the variables of demographics, inflation, and politics is to challenge individuals to save early and often for their own retirement. Individuals will not make this choice as long as they believe the government will take care of them in their old age. A phased, incremental reform will allow for a period of transition between the old system highlighted by government control and a new system highlighted by individual responsibility.

The reform advocated by this paper may seem minimalist and technical. It is. Social Security needs to be reformed to more adequately reflect the role of the individual and the role of government for providing retirement income.
For Social Security reform to be successful, the plan cannot expand the government's role. While the three Advisory Council proposals would solve the financial problems facing Social Security, the result of the reforms would be new programs, new regulations, and new bureaucracies.

The philosophy of government has changed dramatically since the 1930s. Americans no longer trust government to solve society's problems. Social Security, because of its historical popularity and design, has not been sufficiently changed in response to this new perception. Myths surrounding Social Security distort individuals' behavior and increase individuals' vulnerability to factors and institutions beyond their control. Only by reducing Social Security can we have a government that is financially sound and more adequately reflects a balance between the responsibilities of the individual and the responsibilities of the state.

Notes

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10 Ibid.

11 Ibid.

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