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PUT THE SOCIAL SECURITY TALKS ON HOLD

Rep. Bill Archer (R-TX), chairman of the House Ways and Means Committee, is attempting to engage President Clinton in a dialogue on Social Security reform and is also reaching out to Democratic members of the Ways and Means Committee. Rep. Archer brings to the table a Social Security plan that he has introduced with Rep. E. Clay Shaw (R-Fla), chairman of the Ways and Means Social Security Subcommittee.

The Archer-Shaw proposal contains many compromises, omitting various features to which the President might object. Rep. Archer accurately characterizes his plan as "meeting the President halfway." While the idea of trying to find common ground is appealing, the President's proposals so heavily emphasize government control and income redistribution and the Archer-Shaw plan is already so modest that any mixture of the two would likely be worse, not better, than current law.

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Effective Social Security reform needs to have three elements. It must rein in the unaffordable Social Security system by trimming excessive growth of real per capita benefits. It must compensate workers by letting them redirect some of their taxes into real personal saving. And it must be funded in a manner that boosts national saving and improves the economy's performance to make it easier to care for an increasing number of retirees. The goal of these initiatives is to shrink or eliminate the current, unsustainable tax/transfer system and replace it with real, funded saving by each generation for its own retirement. Neither the Archer-Shaw plan nor the Clinton proposals adequately meet these requirements.

Archer-Shaw is primarily a better "lock-box" to prevent Congress from spending current Social Security surpluses. It would also take a short step away from the current tax/transfer program by replacing a small portion of Social Security with personal saving accounts. Archer-Shaw's limitations are that it would leave most of the Social Security system in place, that it would not restrain the large projected growth of promised real benefits, that it would not create incentives to boost national saving, and that it would give individuals no freedom in choosing how to withdraw funds from their new personal accounts.

In the Archer-Shaw plan, individuals would claim special refundable income tax credits equal to 2% of wages, up to the Social Security wage base ($72,600 in 1999), and would have to contribute the credits to "Social Security guarantee accounts". (The plan could be made clearer if it did not inject an income tax credit into the funding mechanism but, instead, simply reduced the Social Security tax by 2 percentage points and required those 2 percentage points to be put into the new accounts.)

An additional feature of the Archer plan is that it would abolish the Social Security earnings limit by 2006. Currently, seniors aged 62-64 lose 50 cents of Social Security benefits for every dollar they earn above $9,600 (threshold indexed by wage

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1730 K Street, N.W., Suite 910, Washington, D.C. 20006
Voice 202-463-1400 • Fax 202-463-6199 • Internet www.iret.org

growth) and seniors aged 65-69 lose 33.3 cents of Social Security benefits for every dollar they earn above $15,500 (threshold rising to $30,000 by 2002, then indexed). The earnings test is a very powerful work disincentive that deprives seniors of income and the economy of valuable labor services. Repealing the earnings test is highly desirable and should be enacted, regardless of whether broader Social Security reform can be accomplished this year.

Mr. Archer correctly states that his plan would not be a tax increase. However, except for repeal of the earnings test, it would not be a tax reduction, either, despite references to the refundable credit as a tax cut. The government-required payments into the new guarantee accounts would be taxes, although the plan does not describe them that way, and they would exactly offset the credits.

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The Archer-Shaw plan would not generally increase people's total retirement benefits. At retirement, the government would take over each person's guarantee account and convert it into an annuity. The annuity would cover a portion of the Social Security payment to the retiree, with the rest made up from payroll taxes as in current law. A retiree would get a payment equal to the currently promised Social Security benefits, paid for partly by the new personal retirement account's earnings and assets and partly by payroll taxes. The federal budget would generally be the winner from the new accounts, not savers. Only if the personal account would yield an amount greater than current benefits (highly unlikely with only a 2% set-aside and the limited investment options) would the retiree's total monthly benefits rise.

The plan's explanation describes the accounts as "personally-controlled" because individuals could make some choices regarding how their accounts were invested, but, in fact, personal control would be severely limited. Individuals would be required to keep 60% of their accounts in stocks and 40% in bonds; they could not withdraw anything prior to disability or retirement; and they would be forced to have their accounts annuitized at that time. Any gains due to clever investment by the individual would only save the government money, not boost the individual's retirement income. However, if a person died before retirement, the amount in the new account would pass to the individual's heirs, an improvement over current law. This is the only instance in which the individual — or rather, his estate — would have real ownership of the assets.

The new accounts would be counted as additions to personal saving, but the new tax credits would produce offsetting reductions in government saving, leaving national saving unchanged. Beyond the mandated accounts, the proposal would not expand IRA or pension opportunities to give individuals any incentive to save more than they do now.

What the Archer plan would do is provide a secure lock-box. If the new accounts are treated for federal budget purposes as belonging to individuals, they would not appear in the federal budget as government revenues. Also, they would not automatically be invested in government bonds. Thus, the federal government could not easily turn them into a financing source for other government programs. This would differ from surpluses in the Social Security fund, which the federal government has historically used to help pay for general government operations. In short, the main virtue of the Archer plan is that it might more effectively restrain government spending than does Social Security's current financing structure.

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hope of replacing the system with real saving, and would do nothing to strengthen the economy.

President Clinton has two proposals directly linked to Social Security. One recommendation is that 62% of projected unified budget surpluses over the next 15 years be credited to Social Security. Because a large share of the surpluses represent Social Security taxes in excess of Social Security outlays, they are already being credited to the Social Security Trust Funds. By crediting the surpluses to Social Security a second time, the President's proposal would generate massive double counting and lead to a flood of IOUs from the Treasury to Social Security. But contrary to the Administration's assertion that the IOUs would provide "more than $2.7 trillion in additional resources available to meet future Social Security benefit obligations," the credits would not increase the government's ability to pay future claims by even one cent: IOUs shuffled around within the federal government are not real resources. The main effect of the double counting would be to lull people into misguided complacency about Social Security's long-term solvency, delaying the reform efforts needed to head off Social Security's eventual bankruptcy.

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Another Presidential recommendation is that the government begin investing Social Security funds in the stock market. Supposedly, the higher returns earned on stocks would increase the resources available to pay Social Security's future bills. A fundamental problem with this scenario is that while the proposal would redirect government saving, it would not increase either government saving or private saving. Since the portfolio shift would not increase national saving, it would not raise the economy's productivity and output. Thus, the real burden of Social Security benefits, relative to the size of the economy, would be as great as ever. An additional concern is that if the federal government began investing in the stock market, it would soon accumulate a huge stock portfolio that it could use as a club to force private-sector businesses do its bidding. Although the Administration insists that it would insulate government investment choices from politics, Federal Reserve Chairman Alan Greenspan and others are worried by this danger.

The Administration also wants to create Universal Savings Accounts (USAs). The central feature would be a $300 yearly *automatic credit* for individuals ($600 for couples) that the government would give to everyone with earnings between $5,000 and $20,000 for individuals (up to $40,000 for couples) who are between the ages of 18 and 70. The credit would phase out over the next $20,000 of income for individuals ($40,000 for couples). Another feature would be a *matching credit* if people put some of their own saving into the USAs. The matching credit also would be phased out with rising income.

Reform should be built on bolder proposals that tackle the real problems.

Although the USAs would be retirement accounts in that people could make no withdrawals before age 65, the Administration rejects the idea of linking them to Social Security reform. Hence, the USAs would simply be a new government income redistribution program. The automatic credit would be an income transfer out of federal tax revenue — not new national saving — and would not provide individuals with any incentive to save more themselves. Creating $300 credits out of thin air does not raise saving and productivity. Indeed, because the automatic credit would penalize individuals within its phase-

out range if they work and save more, it might actually *slow* saving and economic growth. That would make it *more* difficult in the future to extract sufficient taxes from workers to pay Social Security benefits to retirees. The matching credit would be an income transfer, too, but at least it would offer some personal saving incentive to people with low incomes. For people within its phase-out range, however, the loss of the matching credit would create a work and saving disincentive.

The USAs would also set back genuine reform efforts because the President would have given away the "quid" without getting the "quo". The automatic and matching credits should be used as "sweeteners" to gain workers' acceptance when Social Security is inevitably scaled back to a more affordable level. Instead, the President gives them away without reforming the system and would then have no sweetener to spread around when benefit growth must be pruned.

Effective Social Security reform needs to be carried out on two fronts. One requirement is to curb the sharp rise in real per capita Social Security benefits projected under current law. Another is to increase the nation's ability to pay future Social Security benefits by enacting tax changes that spur growth through improved work and saving incentives. Because Mr. Archer's plan is too limited to advance these goals while Mr. Clinton's proposals would generally move in the wrong direction, a compromise between them is not a sound basis for Social Security reform. Reform should be built on bolder proposals that tackle the real problems.

Michael Schuyler
Senior Economist

Note: Nothing written here is to be construed as necessarily reflecting the views of IRET or as an attempt to aid or hinder the passage of any bill before Congress.