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A Good Time to Revive Social Security Reform?

By Andrew Biggs

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The Cato Institute's Mike Tanner—my former boss and a great guy—writes in today's Washington Times that now may be the time to revive Social Security reform. Social Security's financial problems have worsened over the past year due to the recession. And, perhaps more importantly, the apparent healthcare overhaul—and its always-dubious promise of fixing the budget by lowering health costs—means that policy makers must look elsewhere for budget savings. Social Security has to be addressed sooner or later, and with healthcare on the back burner, now is as good a time as any.

But it's also worth revisiting what made Social Security reform so hard the last time it was tried in 2005. Tanner writes:

> If Social Security's problems haven't changed since the Bush years, neither have the

> possible ways to fix those problems: Raise taxes (the Social Security payroll tax would have to be nearly doubled to keep the program afloat), cut benefits by as much as 25 percent or allow younger workers to invest privately.

Here's where I differ a bit with my more libertarian brethren.

Back when I was on the staff of President Bush's 2001 Social Security reform commission, we wrote in our interim report that once Social Security begins to run cash deficits in 2016 we face the ugly choices to "raise taxes, reduce benefits, decrease other government spending, or increase borrowing from the public."

Wise guy that I was—a habit that I assure you I've given up—I remarked to one of the other staffers that with personal accounts we face the same choices, only sooner. That is, when you divert payroll taxes that currently fund today's benefits to private investments, you've got to find money to fill that gap. Funding these so-called "transition costs" involves the same choices as before: raise taxes, cut spending, reduce benefits, or borrow.

And this is one place where reform fell down in 2005. No one was willing to raise taxes or cut spending, and President Bush's plan already would have reduced benefits just to fix the program's solvency. As a result, the accounts would be funded entirely by borrowing. This all but eliminates the economic case for accounts, which relied on increased national saving to boost the economy's ability to support larger populations of retirees with smaller populations of workers. Funding accounts with debt is like borrowing from your 401(k) to invest in your IRA—total saving doesn't change.

Politically speaking, the debt associated with these transition costs was a loser. It was hard to convince the public you were taking the fiscally responsible route—which, overall, President Bush was—when the plan involved a few trillion in new borrowing.

I'm not sure how a Social Security reform plan today addresses these problems any better than plans in 2005 did, which is why I'm skeptical of the success of accounts funded out of the payroll tax. I support them, but unless people are willing to make tougher choices than they've shown themselves to be, I don't see how it happens.

But when Social Security reform does come up, personal accounts still have a role to play. The Left will favor fixing Social Security the way we've generally fixed it in the past, by raising taxes. But if we need more money to fund Social Security benefits—which isn't illogical, given that people are living longer—then people should have the option to save those extra contributions in their own accounts rather than paying to a system that may or may not save them in the "trust fund" and may or may not pay them back in the future. That's a place where personal accounts have a real role to play, and an argument that account supporters can win.

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