
The current debate over Social Security reform can be viewed as the contemporary manifestation of a long-running contest between the right and left over which values, ideology, and political philosophy should guide public policy with respect to old-age security. Those calling for partial privatization and other regressive “reforms” of Social Security have much more influence today than they had during the 1960s, the 1970s, and even the 1980s. Conservative commentators seeking to undermine confidence in the Social Security program (e.g., Butler & Germanis, 1983) seem to have had some success even though support for the program remains high (Reno & Friedland, 1997). Conservative analysts and commentators were successful in moving proposals to partially privatize Social Security to the policy mainstream by the mid 1990s as illustrated by the publication of the Final Report of the 1994–1996 Advisory Council on Social Security (Advisory Council on Social Security, 1997).

One reason for the success of conservative commentators has been their focus on getting their message out to the general public, particularly through radio and TV talk shows and the print media. It is not just the Wall Street Journal that has been strongly backing privatization and other regressive Social Security reforms. Support has been strong in many local and regional newspapers as well (e.g., see Ekerdt, 1998). While some liberals and liberal advocacy groups have also focused on the general public, many liberal analysts of Social Security have tended to address their arguments to academic audiences, a strategy that has limited their impact on the public debate. This is one reason that Social Security: The Phony Crisis, by Dean Baker and Mark Weisbrot, is an important book that may become very influential. It is an unusually lucid liberal analysis of the key issues in the current debate over Social Security reform that journalists and general readers will find relatively easy to understand.

Conservative critics of Social Security have argued that due to the size of the baby boom cohort, it is not going to be possible to pay the Social Security pension benefits currently being promised to them. Those in the labor force during the retirement of the baby boom cohort will be unable and unwilling to accept the economic burden of paying those pension benefits. Some go so far as to argue that by the mid 2030s the Social Security trust fund will be bankrupt, and they at least imply that there will be little if any money available to pay pension benefits. A related argument stressed by commentators on the right is that the imputed rate of return on contributions to Social Security by today’s younger workers is likely to be far below what it would be if they were allowed to invest at least a portion of their contributions in the stock market. Given the attention in the popular media to the aging of the baby boom generation and to the high rates of return being achieved in the stock market year after year, particularly during the late 1990s, it is easy to understand why the arguments calling for the partial privatization of Social Security have come to be viewed as quite reasonable by many Americans. During the 1980s and 1990s, conservative analysts and commentators largely achieved their threshold objective: they convinced many Americans that there was a Social Security “crisis” and that major changes, possibly including partial privatization, might be needed to “save” the program.

One of the most important arguments Baker and Weisbrot make is that “privatizers” (their name for those calling for the partial privatization of Social Security) are using smoke and mirrors when they estimate that the average rate of economic growth will be about 1.5% over the next 75 years while the average real rate of return on investments in the stock market will be about 7% per year. Although it might be possible for a 1.5% growth rate to coexist with an average return of 7% for short periods of time, such a pairing would be very unlikely over a period of 35 or 75 years. That is, it is possible in the short run for the price of stocks to be bid up very high in anticipation of future earnings (as in the case of internet stocks during 1999 and early 2000), but in the long run there is a limit to the price to earnings ratios investors will find acceptable.

What is the flaw in the privatizer’s argument? Over the long run (a period of several decades) the rate of growth of the overall economy sets limits on how much the stock market is likely to appreciate. The 7% average growth estimate used by privatizers was achieved during the post-war period when the average rate of growth of the economy was about 3.5%. If we assume the much lower rate growth rate of 1.5% during the years ahead, it is not reasonable at the same time to assume a 7% average annual rate of growth for the stock market; this is particularly true when the price to earnings ratio for stocks is already very high by historical standards. A reasonable estimate would be much below 7%. And after one factors in the high cost of administering individual accounts, the rate (according to Baker and Weisbrot, maybe as low as 2.5%) would be so close to that yielded by the Treasury bonds currently held by the Social Security trust fund that there would be little if any public support for privatization.

Some privatizers will, of course, point out that in recent years the average rate of economic growth has been substantially above 1.5% (due to the impact of technological innovation on productivity) and that it is entirely possible that we will achieve average rates...
of return far above 1.5% for many years to come. This may be true. However, as Baker and Weisbrot point out, if the rate of growth of the economy were to approach the average of 3% realized over the past 75 years, incomes would rise to the point that there would be no Social Security financing problem (not in the mid 2030s or in the mid 2070s) and thus there would be no rationale for the radical transformation of the program called for by the privatizers.

Privatizers warn of the crushing burden that tomorrow’s workers will face when the Social Security trust fund is exhausted in the mid 2030s. What they often neglect to say, as Baker and Weisbrot point out, is that even in the unlikely event that no policy changes were made between now and then, and all of the funding gap were made up at that time by suddenly increasing the payroll tax, the after-tax income of those workers would be substantially (close to 30%) higher than it is today. While I am less confident than Baker and Weisbrot that the impact of the needed payroll tax increase would go almost unnoticed by most workers, they do have a good point that those workers will not be impoverished by the increased payroll tax burden despite claims to the contrary by some alarmist privatizers.

The authors include a good discussion of what they refer to as the “entitlement trick” that they link to privatizers such as Peter Peterson, president of the Concord Coalition. The reference is to efforts to make the case that Social Security is in a state of “crisis” by lumping it together with Medicare and then making long-term projections of the cost of “entitlements” (a term used to refer to both components together), assuming that the rate of increase in spending on Medicare continues at the high (and unsustainable) rates of the past couple of decades. Baker and Weisbrot acknowledge that Medicare faces some major funding problems and that spending on that program cannot continue to increase at the rate it has in recent decades. However, their major point in this context is that Social Security and Medicare are two separate and separately funded programs. For this reason it is intentionally misleading to attempt to make the case for a “crisis” in Social Security funding by indirectly linking it to Medicare, a separate program that faces a much more serious and difficult-to-correct funding problem.

Although Baker and Weisbrot focus on the debate over the proposed partial privatization of Social Security (which is understandable given the attention to the issue in the popular press), they also make a number of important points regarding other reforms that are currently being debated. It is generally agreed, even by proponents of privatization, that in the short run privatization will not solve the Social Security funding problem. Liberal defenders of Social Security are quick to point out that if you start diverting a sizeable fraction of the payroll taxes into individual accounts, a way must be found to make up much of the difference because additional funds will be needed to pay benefits to those who are retired and those who will soon be retiring. They point to the irony that those “reformers” who seek to “save” Social Security by diverting a portion of payroll taxes will be making the projected funding shortfall more serious, unless their plans also include provisions calling for changes that add up to some combination of direct or indirect benefits cuts and payroll tax increases.

One such proposal is to increase the number of years of earnings used to compute the Social Security benefit from 35 to 38 years. This change would have adverse consequences for women and for low-income workers in general.

Another is to increase the age of eligibility for full retirement benefits still further (it is already scheduled to increase from 65 to 67 by 2027). A concern here is the potential impact on workers who are members of racial and ethnic minorities, and on low-wage workers more generally. Baker and Weisbrot consider the case of the average Black male worker who was 39 years old in 1999 and who retires at the full benefit retirement age for his cohort. According to current estimates, such a worker can expect 2.3 years of benefits before death as opposed to 8.4 years for his White counterpart. If the age of eligibility for full benefits were increased by an additional year, the reduction in expected lifetime old-age pension benefits for the average Black worker would, according to the authors, be much greater than for the average White worker. If we were to factor in the disproportionate payment of disability benefits to Black workers, the imbalance would, however, not be as great as they suggest. A parallel argument can be made with respect to low-wage workers generally. While we can quibble about the details, their main point is correct. Any effort to close the gap between Social Security spending and revenues by increasing the age of retirement will have a regressive impact.

Baker and Weisbrot also discuss proposals to modify the formula used to make the annual cost-of-living adjustment (COLA), which is tied to the Consumer Price Index (CPI). The proposal to shift to a less generous formula would have its greatest impact on the overall economic status of those at the lower end of the income distribution because Social Security benefits make up a much larger share of retirement income for these pensioners than for others. It would also have a regressive impact on women, who not only tend to have lower incomes, but also tend to live longer, allowing the compound effect of a less generous COLA formula to put added downward pressure on their relative living standards as they grow older. The book includes an entire chapter on the CPI and problems with the various proposals for making it less generous in the name of making it more accurate. Proponents of such changes do not give adequate attention to the evidence suggesting that due to difference in consumption patterns, changes in the cost of living vary among population subgroups. Of particular relevance in this context is evidence suggesting that the current index may well understate rather than overstate (as many conservative commentators claim) trends in the cost of living for older persons (due, for example, to age differences in
the amount spent on prescription drugs and other out-of-pocket medical expenses).

There is an excellent chapter on generational accounting, an issue that is also central to the debate over generational equity more generally (see Williamson, Watts-Roy, & Kingston, 1999). It offers an unusually clear presentation of this complex modeling procedure and a detailed evaluation of the technique. Some privatizers have used models of what they refer to as generational accounting to argue that Social Security as currently structured is a bargain for those who are already retired, but this bargain comes with a very high cost to present and future workers. It is used to argue that the present system is putting an unfair burden on current workers and that it will put an even less fair burden on future workers. The generation accounting model is used to estimate an age cohort's "lifetime tax burden" and to argue that if current trends continue, that burden will increase for each successive age cohort. The tax burden is computed as a "net tax" that includes all taxes a person pays over a lifetime, less benefits from government programs such as Social Security and Medicare. Baker and Weisbrodt point to a number of serious problems with the model.

To mention one example, in the standard way of doing generational accounting (Auerbach, Gokhale, & Kotlikoff, 1991), spending on education is often treated strictly as an expense (a burden, not a benefit). According to the model, as interpreted by Baker and Weisbrodt, this leads to the anomalous conclusion that the more government spends on education for children, the worse off they are. If instead you treat this spending as a benefit for children, the computed net lifetime tax burden for future generations would be reduced by about one-third.

The book also includes a chapter on Medicare reform. One useful part of this chapter is the comparisons made with other industrial nations. Data are presented indicating that the United States spends a greater share of its gross domestic product (GDP) on health care than does any other industrial nation, despite having a relatively young age structure. Baker and Weisbrodt argue the reason is that the price of health care in this country is driven much more by prices in the private sector (including the ever-increasing prices of drugs and expensive medical technology) than is the case in these other industrial nations, which have national health insurance schemes. Another interesting argument in this chapter is that most projections of the future cost of Medicare assume that age-specific disability rates will remain the same as life expectancy increases in the years ahead (e.g., Lubitz, Beebe, & Baker, 1995). However, such projections ignore the evidence that as life expectancy increases, age-specific disability rates are likely to decrease (see Manton, Corder, & Stallard, 1997).

Baker and Weisbrodt are highly skeptical of the accuracy of long-term economic forecasting. They suggest that the Social Security shortfall currently forecast to occur at some point during the 2030s may never happen, even if no policy changes are made between now and then. They are critical of policy analysts who are willing to assume that major reform is needed just because there is a public perception (largely created by conservative commentators) that we will be facing a crisis some 30 or 40 years from now. They argue that there is no pressing need for major changes in Social Security policy during the next few years. Even before George W. Bush was elected president, the authors were of the view that any major Social Security reform legislation would best put off until the political climate for progressive reforms changes. No doubt, they would argue that point even more strongly today. Due to this take on the current debate over Social Security reform, they offer even progressive proposals with some reluctance.

However, they recognize that some reforms may be inevitable, and that liberals should have some progressive alternatives to counter those that will inevitably be made by conservatives. So, the authors spend some time outlining reforms that could be made that would help close any gap between spending and revenues in such a way as not to put a disproportionate burden on people with low incomes. In this context, Baker and Weisbrodt discuss proposals such as: (a) lifting the cap on the payroll tax (currently $82,400) to a level at which 90% of all wages would be taxed; (b) lifting the cap entirely on the employer’s portion of the payroll tax while leaving the cap on the worker’s half unchanged; (c) making the Treasury Department pay a higher interest rate on the bonds through which it borrows money from the Social Security trust fund; and (d) shifting all of the federal income tax revenues paid on Social Security pension income to the trust fund. The first two proposals may be given some attention in the current debate; I suspect that the last two will get little if any attention.

At the core of the argument made by advocates of privatization is that it will lead to an increase in the size of the GDP, making it much easier to support the retirement of the baby boom generation. Most economists agree that if national savings can be increased, this will lead to an increase in the rate of investment, which in turn will increase the rate of economic growth leading to a larger economy when the boom cohort retires. Baker and Weisbrodt include an excellent chapter dealing with this proposition. The thrust of their argument is that any relationship between an increased savings rate and trends in economic growth is likely to be weak. They discuss why it is very difficult to increase savings rates via government policies such as the partial privatization of Social Security. They go on to argue that any impact of an increase in savings on investment is likely to be weak as is the impact of any increase in investment on the rate of economic growth.

For me, the most important limitation of this book is that it does not give adequate attention to the issue of risk in connection with proposals to partially privatize Social Security. As I see it, the phenomenal stock market during the 1980s and 1990s has made it difficult for many to recognize the implications of, say, a 40% drop in the stock market in the year just before a worker retires (Williamson, 1997). Many
workers will not have the option to continue at work another 1, 3, 5, or 10 years for the market to get back to a level at which retirement is economically feasible. For low-wage workers, any such drop could have a profound impact on post-retirement living standard. For the affluent, who tend to be the strongest advocates of privatization, the impact on living standard would be less, possibly much less, in part because Social Security would make up a smaller share of their retirement income, and in part because they would not be living as close to the poverty line.

In summary, this book provides an exceptionally clear and persuasively written liberal analysis of the issues involved in the current debate over Social Security reform. It does a convincing job of responding to many of the arguments that have been set forth by proponents of the partial privatization of Social Security. While it is a must read for economists dealing with Social Security issues, its primary value will be in presenting these ideas to people without degrees in economics. The authors do an excellent job of cutting through the technical jargon that makes much of the scholarly debate over these issues inaccessible to many general audience readers.

Prospects for Social Security Reform, edited by Olivia Mitchell, Robert Myers, and Howard Young, is one in a series of edited books based on papers presented at what has become an annual conference held at the Wharton School and sponsored by the Pension Research Council. In contrast to the book by Baker and Weisbrot, this book starts with the assumption that Social Security reforms are needed and then asks what the policy options are, how best to evaluate the alternatives, and what the reform-related views are of various stakeholder groups such as organized labor and employers.

The 18 chapters of this book are divided into three parts. The first section consists of four chapters. The first chapter is an overview of the book by the editors. A chapter by Stephen Goss deals with measuring and making long-term projections about the solvency of the Social Security system. In a related chapter, Stephen Kellison and Marilyn Moon discuss how future trends with respect to benefits and taxes are projected. A chapter by Joseph Quinn lays out several criteria for evaluating Social Security reform proposals. Among those he mentions are impact on income adequacy, individual equity, economic growth, administrative costs, public confidence in the program, the complexity (and transparency) of the program, employer pension plans, social cohesiveness, and long-run political support.

The second section of the book includes seven chapters. A chapter by John Geanakoplos, Olivia Mitchell, and Stephen Zeldes deals with the issue of money’s worth or individual equity. Gordon Goodfellow and Sylvester Schieber present simulation results for several different Social Security reform options. Their simulations suggest that with partial privatization, some people will end up with smaller pensions than under the current scheme, but many more will end up with larger pensions. Their models also suggest that privatization may well leave the middle baby boom cohorts worse off than they are under the present scheme. A chapter by Martin Holmer examines the impact of several reform options on economic growth, concluding (in contrast to Baker and Weisbrot) that options that increase national savings will have a significant impact on the rate of economic growth, thereby making it easier to finance future pension benefits. Kent Smetters discusses the relative merits of investing the Social Security trust fund in equities and the relative merits of pre-funding as opposed to privatization. George Pennacchi deals with the pension guarantees that governments often make in connection with privatized schemes and how the cost of such guarantees can be estimated. A chapter by David Neumark and Elizabeth Powers deals with means testing. And Robert Hutchens uses simulation models to analyze the relationship between Social Security policy and employer efforts to encourage older workers to retire.

The third section of the book comprises seven chapters. Joyce Manchester explores the problem of payroll tax evasion in social security systems around the world. She finds that compliance is often a serious problem in developing countries, but much less of a problem in developed countries. Chapters by Janice Gregory and Christopher Bone both address the impact of various proposed Social Security reforms on employer-sponsored pension plans. David Blitzstein discusses organized labor’s opposition to reforms that call for the partial privatization of Social Security. A chapter by Robert Pozen and John Kimpel deals with two major issues. The first is the need to put some limits on investment options in a privatized scheme so as to maintain an appropriate balance between risk and return. The second is the need to set some constraints with respect to administrative options. They suggest that the inclusion of a large number of very small accounts will lead to high administrative costs. John Rother and William Wright present an analysis of public opinion on several possible Social Security reforms. And Karen Holdren’s chapter looks at the impact of various proposed reforms on widows, with particular attention to the potential adverse impact of privatization.

The chapters in this book are of consistently high quality. But due in large part to variation in length (from less than 7 to more than 70 pages), there are differences with respect to the detail of the analyses presented. This volume is directed primarily at an audience of economists and technical policy analysts. Several, but by no means all, of the chapters assume some familiarity with econometrics and simulation techniques.

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REFERENCES

