Salvaging Social Security; Individual accounts may be part of the answer

Commentary

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Washington - President Clinton's budget for fiscal 1999 contained a masterstroke. His proposal to save the budget surplus until Social Security is reformed has stymied Republican tax cutters.

It may not, however, have thwarted Republican spenders, who have decided to splurge on highways. Congress is threatening to pave over America.

There will be efforts to cut other spending to make room for highways. But it will be remarkable if Congress does not violate the spending limits adopted as part of the 1997 budget agreement with the president.

In other words, highways could capture some of the surplus before anyone else can grab it.

But the good news is that the surplus is likely to be considerably larger than expected, and one hopes that the excess can be used for better purposes.

Many have wrongly interpreted the president as saying that the surplus should be devoted to shoring up the present Social Security system. It would be tragic if that were the outcome. The present system is not sustainable. Using the surplus to support it will only postpone the date of bankruptcy.

The surplus could, however, be used to ease the pain of reforming the present system.

A broad consensus seems to be evolving - among groups and policy-makers ranging from the libertarian Cato Institute to Democratic Sen. Daniel Patrick Moynihan of New York - that the growth in promised benefits must be cut back. The consensus is that individuals must be encouraged, or even forced, to save for retirement on their own behalf.

There are very important differences among the plans of various groups, but the basic idea of all is that the proceeds from the savings accounts can eventually be used to replace - and will probably exceed - lost Social Security benefits.

The creation of such individual accounts is sweeping the world.

Variants on the theme can be found in the United Kingdom, Australia and Chile, among others.

Unfortunately, the adoption of individual accounts faces a huge barrier. It would be unfair to cut the benefits of current retirees significantly.

This means that current workers have to keep paying payroll taxes to sustain these retirees. In addition, they would be expected to pay into accounts to help finance their own retirement.

In other words, they would be financing two retirements: their own and those of current retirees.

Under a proposal from Moynihan, the current excess of payroll tax revenues over benefits would be used to reduce the payroll tax by 1 percentage point for both employees and employers. This move would ease the burden of supporting two retirements and make room for voluntary savings accounts.

But the excess Social Security revenues are temporary. To finance the remaining Social Security benefits in the long run, Moynihan proposes raising the wage base (the amount of your income) to which the payroll tax is applied - and eventually raising the tax rate.

A superior approach would use the budget surplus to finance a more permanent cut in payroll taxes. This would make voluntary accounts more feasible and might make mandated accounts more acceptable.

Once individual accounts are well established, they are likely to become very popular. They will pay a higher rate of return than most individuals receive from their own and their employers' payments to the Social Security system.

In the very long run, with Americans less dependent on Social Security, benefits and the payroll tax can be cut further, thus making room for more increases in individual accounts.

During the next few years, the budget surplus may not be large enough to finance a meaningful cut in payroll taxes. However, running a modest deficit to help finance Social Security reform is not all bad.

To the extent that the reform reduces the future growth of benefits, the government is ridding itself of a liability to future retirees. That reduction of liability does not show up as a reduction in the national debt, but it is similar in its economic implications.

Replacing some of the liability to future Social Security beneficiaries with the Treasury bonds necessary to finance a modest deficit is not objectionable as long as it does not get out of hand. If the deficit gets too large, it can be countered with other spending cuts. Highways might be a good place to start.

Other Publications by the Authors

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