

Why Social Security reform is still relevant

Andrew G. Biggs
American Enterprise Institute

Global Aging Initiative
Center for Strategic & International Studies
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Recent history

- 2005 Bush administration reform effort fails
- CBO projects smaller shortfall than Trustees
- 2008 Trustees Report: Deficit falls from 1.95% to 1.70% of payroll
- Increased emphasis on healthcare...

Is health care cost growth the real – or only – problem?

- CBO: Medicare/Medicaid bigger issue than Social Security
- Health care cost growth, not population aging, real problem.
- Popular inference: Forget about Social Security, focus on health care
- Is this view correct?*

Social Security is larger near-term problem

- Medicare grows at faster rate, but for next several decades Social Security's absolute cost growth is larger
- Between 2008-2035, Social Security costs increase by 1.8% of GDP; Medicare A&B costs by 1.5%.
- Social Security growth is either a "Social Security problem" (raise taxes, cut benefits) or a "general fund problem" (repay Trust Fund), depending on perspective

Medicare about tomorrow's costs, Social Security about yesterday's

- Social Security shortfall entirely due to over-generosity to *past* participants.
 - Sunk cost, can't be reclaimed, just managed. The sooner reform enacted, the more cohorts it can be spread across.
- Medicare shortfall due to rising costs for *future* participants.
 - While action is important, generational fairness doesn't demand it take place immediately. Cutting costs at the time costs occur is fine.

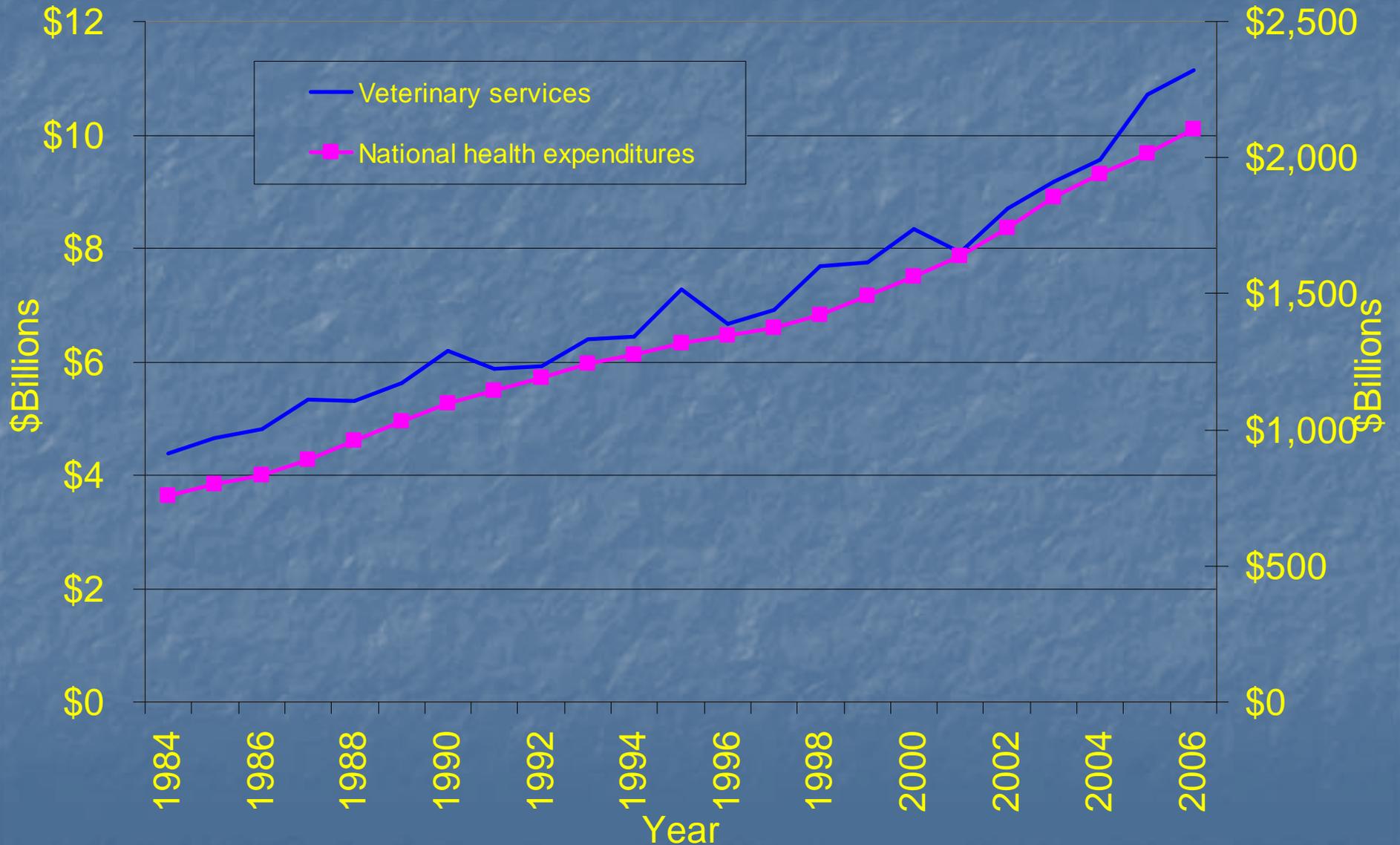
Cutting benefits post-entitlement

- Once person retires, Social Security benefit rises only with CPI
 - Politically, benefits hard to reduce post-entitlement. Once cohort retires, lifetime benefits are set.
- Medicare benefit rises with age/usage, medical price inflation
 - Medicare reform could reduce costs for both future and current beneficiaries.
- Cost of waiting higher for Social Security. On Medicare, might be acceptable to wait until we have cost-saving methods *right*.

We don't know how much health care is too much

- Health care costs rise primarily due to technology; income effects; insurance effects (declining out-of-pocket payments). Only last truly problematic.
- Hall & Jones: By mid-century, individuals would *want* health care to consume 1/3rd of GDP
 - Even more conservative estimates imply large spending increase
- That said: If cost restraints focus on efficiency, we gain regardless of ultimate desired cost level

Health spending: People vs. Pets



We do have pretty good idea how much people need in retirement

- 70% replacement rate rule-of-thumb; life cycle analysis
- Possible to calculate appropriate retirement income even for distant future
- Policy question: How to *divide* retirement income between mandatory/pay-as-you-go/DB and voluntary/funded/DC.
- Not easy question, but *easier*.

Social Security more mature policy issue

- Basic outlines of reform debate static since 1994-1996 Advisory Council: increase taxes, reduce benefits, diversify portfolio (higher risk/return)
- We have good idea of size of problem and type/number of policy steps needed to address it
- Smaller problem, easier to solve. Let's chalk up some wins!

Politics: Do the easy stuff first?

- How Medicare is easier: Provides a service, not a dollar amount
- How Social Security is easier: Easy to replace Social Security cuts with more saving; harder to replace Medicare cuts
- Sample slogans:
 - Social Security reform: Work longer, pay more
 - Medicare reform: Suffer more, die earlier

If Medicare is as big a problem as we think,
then we *really* need to fix Social Security

- There are only so many dollars to go around
- The people saying health care is the true crisis are often the ones who say we can't cut Social Security benefits significantly
- But if health costs rise even half as much as predicted, paying scheduled Social Security benefits will push total entitlement spending to 10% of GDP by 2050

Build a vision for Social Security reform

- Get away from bend points/AIMEs/PIAs; think qualitatively
- Why do we have a Social Security program in the first place? What are its goals?
- Do we meet those goals the same way in the future as we did in the past?
- What kind of program should a retiree 50 years from now have?
- Focus on areas of agreement not areas of disagreement.