# Greenspan's Social Security "Fix' Turned Out To Be Anything But

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As chairman of the 1981-1983 National Commission on Social Security Reform, current Federal Reserve Chairman Alan Greenspan implied that only very adverse economic events would create major financial problems with the system after implementation of reforms. The expectation at that time, according to Greenspan and others, was that the Social Security problem had been fixed.

That was 1983. Now more than 20 years later and after a 20-year economic and equity boom that probably exceeded expectations of most, the Social Security system and Medicare system face major unfunded liabilities.

In December 1996, Fed Chairman Greenspan gave a talk at the Union League of Philadelphia in which he said that "the Social Security system, as currently constructed, will not be fully viable after the so-called baby boom generation starts to retire in about 15 years" -- around 2011.
That doomsday date has since shifted to around 2018.

Greenspan, after 15 years of solid economic growth, viewed the Social Security system that was supposedly fixed in the early 1980s as in dire straits. His 1981-1983 commission urged an increase in Social Security tax rates so that Social Security would effectively tax workers in advance. Social Security would take in more money earlier and pay it out later.

According to the December 2004 Social Security trust fund statement on investments held by the Old-Age, Survivors and Disability Insurance Trust Funds, under a column labeled "assets," there is a balance of $1.69 trillion. A minor accounting issue has been uncovered: The $1.69 trillion was spent by Congress. Social Security has been part of the unified budget since about 1970, legislated in by the 1974 Budget Act, so that trust fund receipts are revenues and trust fund payments are expenditures.

Members of the 1981-1983 Social Security commission couldn't help but know that the excess Social Security revenues would be spent by Congress. Commission members were astute and experienced people, wise to the ways of Washington. Members of the commission effectively passed a large tax hike to U.S. workers in order for Congress to increase federal outlays by a cumulative $1.69 trillion more than what it may have otherwise done.

Now tax revenues of $1.69 trillion are needed to fund those so-called assets that Congress has already spent.

Social Security was set up as a pay-as-you-go system -- current workers pay for those retired. It's not a savings or pension system. It wasn't possible to do what members of that commission seemed to have in mind -- save in advance -- without changing the structure of the Social Security system from a pay-as-you-go system to a savings or pension program.

Social Security commission recommendations resulted in hiking Social Security tax rates from a combined 9.35% in 1981-83 to 15.3% by 1990. This includes Medicare.

Meanwhile, the base on which the tax rate is applied also climbed from $32,400 to the 2004 base of $87,900. These have been significant tax increases on all employees and employers.
Starting in the 1970s, the Social Security system was programmed to fail because benefits were indexed to growth in real earnings. Workers are essentially given full credit for the economy's

productivity gains over their working years near the time they tap into Social Security. Over the past 20 years productivity has increased 2% a year on average.

This means -- assuming workers capture a portion of those productivity gains -- that real wages increase faster than prices. Because of this feature, Social Security pays increasing real benefits to each successive generation.

The Greenspan commission could have altered this indexing feature since Greenspan considered the indexing feature previously when he was chairman of the Council of Economic Advisers under President Ford. Once people retire, Social Security benefits are indexed to changes in the CPI so that benefits essentially become a price-adjusted annuity.

There is no increase in national savings due to Social Security because the federal government doesn't save the Social Security revenue -- it is transferred to those retired or spent as part of general federal expenditures. However, potential recipients of Social Security benefits perceive those benefits as a substitute for their individual saving. The effect is to decrease personal saving by recipients by roughly the amount equivalent to their Social Security benefit.

The Greenspan commission developed a nearly ideal two-step system to shift personal responsibility for saving to the federal government: 1) increase tax rates on workers -- baby boomers -- so they would have fewer disposable dollars to save, and 2) at the same time create the illusion that since Social Security was running a surplus, retirement benefits were being built up for them when they retired.

The personal savings rate decreased -- exactly what the policies implied. The effort to "fix" the Social Security system by the Greenspan commission in the early 1980s failed. The idea of privatization of Social Security apparently seems to have been a nonstarter for the panel. Better to do so now than never -- privatize in order to shift individual responsibility for saving back to the individual.

There are excellent proposals for doing so, such as one offered by the National Center for Policy Analysis. Many people are concerned about letting individuals make their own choices about saving. But most workers probably could have made much better saving decisions with their $1.69 trillion than Congress actually did with the workers' $1.69 trillion. Had individuals been allowed to save and invest, society by now would have had much more than $1.69 trillion in aggregate savings.

As it is, Congress didn't save a penny; it made a real mess out of the Social Security system by creating an elderly class dependent on a state check. It is exactly the opposite of what citizens do for most of their life: get an education, find a job, buy a house, get married, have children and so forth. In other words, they take responsibility.

The Greenspan commission shifted the responsibility for saving the $1.69 trillion to the state and off the backs of the baby boomers via higher tax rates. Some proportion of the baby boomers who have taken responsibility all of their lives will suddenly become wards of the state when they retire. And workers in future years have to clean up the mess that Congress created.

Adam Smith suggested that free people would better themselves and would -- "as if by an invisible hand" -- actually benefit the whole of society. Countries ranging from Chile to Sweden have chosen the invisible hand approach.

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