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Opportunities for Savings: Entitlements, Defense, and Non-Defense Discretionary Spending - Opening Remarks

I'm going to attempt to control my own slides. Once we get started. I'm relieved that I'm still being allowed to speak, with Bob and Paul suggesting that the Social Security problem is too small (15:40) to even worry about. Nevertheless it seems it's worth doing, and part of it is compared to Medicare and Medicaid and health spending generally. This falls in the category of low-hanging fruit.

(Short pause due to technical difficulty)

This is the starting place for talking about Social Security. It is the annual report of the trustees, the cashflow projection year-by-year. That roughly horizontal line, a little bit out of range I guess, is the revenue coming in relative to taxable income. It's not perfectly horizontal because some of the revenue from taxing benefits goes back to social security, but it's pretty flat at the payroll tax rate. The line that's first solid and then dotted is what it would cost to pay all of the benefits in the benefit formula, ignoring the fact that the trust fund runs out of money at the place where the solid line drops down. Because by law benefits can only be paid out of the money that's there. The very sharp rise that comes first, no surprise, that's the retirement of the baby boomers. And beyond that, after they've died out, we have a little dip, the steady rise in the long term is the expectation of improving mortality going on indefinitely—indefinitely in social security terms, in 75 years. That's long enough things beyond that might not make a whole lot of sense.

So that's there. How big is it? (pointing to slides)

There, with the two horizons that get presented 75 years, which to my mind makes sense, long enough to show the patterns developing. Beyond that we're in science fiction land. I don't know that it makes a whole lot of sense to worry about but infinite horizon is there. I have the deficit there in three different terms. The 15.1 trillion dollar figure is what you would use if you wanted to tell people this is an unbelievably big problem. It's so big we've got to do something radical. And the 0.7 percent of GDP is the way to say this is such a small problem let's not worry about it. My favorite number and the one that makes sense is that 1.9 percent. It makes sense, first of all, for being seventy five years. It makes sense, secondly, because the program is keyed off payroll. Benefits are determined by earnings subject to tax. Revenues overwhelmingly are coming out of payroll. Any fix we are going to do will still involve the system tightly tied to payroll. So that gives you this size of the problem.

Now some people think that's just one projection and that's all it is, one projection. What happens if we make the argument that somehow this isn't going to happen, we really don't need to worry about it. Well both the office of the actuary of social security and CBO do stochastic projections. They may not incorporate everything you think ought to be incorporated, but it's meant to give you a much broader picture of all the different things that might happen. And this is my favorite chart because it makes the point that

you can't think in terms of a single projection. You've got to think of all the different things that might happen and this is the probability of the trust fund hitting zero. And under current law, which obviously we'd get changed the night before if not earlier, the checks don't go out at that point. And you can see the probability—they don't say a hundred percent, but what in life is 100 percent—but the probability of social security running out of money is just way too large for anybody to feel its okay to ignore it.

So then the question is if we're not going to ignore it because the problem is real, is it good to address it sooner rather than later? And I want to answer that just within the context of social security. From the previous panel, maybe if we get this passed, that will satisfy the financial markets a little bit and this and that. Let me just focus on social security. The longer we wait, the larger the annual changes need to be to fix that gap when we run out of money.

So doing it sooner just makes it an easier problem and on the policy side means the sizes of the impacts on people are going to be smaller. Secondly, proposals for reform, including the ones that came from the commission appointed by President Bush, normally include improvements in social insurance for the vulnerable as part of the package. Doing something significant for vulnerable groups without restoring actuarial balance seems to me to be a total political non-starter. So if you'd like to do something for low earners, long-career low earners, for widows, for orphans, for the disabled, you know your only chance of doing it is packaging along with restoring actuarial balance. And the third reason is it's going to be a much better policy if it's done by people who think social insurance is a good idea, and the people who think social insurance is a bad idea have as little say in the process as possible.

Let me remind you President Clinton in the State of the Nation address wanted to put all the additional resources from the surplus into social security. Remember his slogans say social security first. In contrast, President Bush, when he set up his commission, one of the criteria he was supposed to satisfy was no payroll tax increase. If you think social security matters, you've got to believe social security needs more resources. You can not politically, and I would think it would also be wrong in terms of policy, do all of it on the tax side. So what's needed is to get a mix of revenue increases and spending cuts that is an attractive mix. And this is also a view in the eyes of the public.

(technical trouble)

What should be up there is a survey by Alan Blinder and Alan Kreuger asking people in very neutral terms, here is the social security problem, how do you think we should fix it? Mainly by raising taxes, mainly by reducing benefits, or by relying on both, and overwhelmingly people want to not solve the problem just by cutting benefits. So President Bush was really out of step with the American public. But as you can see there the payroll tax is definitely part of the solution but doing something on the benefit side is also part of the solution. The part that absolutely baffles me is that 22 percent. I think of those as the people who are waiting for the tooth fairy to come. So the point here is as a device for raising taxes, social security is a wonderful device.

When you ask people, “do you think we should raise taxes and send money to Washington,” the answer is an overwhelming no. If you ask people “do you think we should raise taxes and earmark that money to finance something that you really care about,” the answer is an overwhelming yes. And social security is something we care about, and social security has this beautiful structure that it’s money in and money out. We don’t really know how to fix all the problems in medical care. That’s not putting down David, he has some good ideas. But everyone understands it’s money in money out. You want the money out, you got to put the money in. So in terms of what is happening with your tax dollars, particularly if you convince people or show them that the administrative costs are really tiny, this is a place where people are really willing to go along with it.

So what kind of plan makes sense? Well you can roll your own. There’s the website. A very large fraction of the ideas that have been floated are reviewed on that website telling you how much of the deficit they take care of. If you don’t want to roll your own, there’s an absolutely fabulous book with a wonderful plan for doing something about it. And let me tell you a little bit about it, no numbers but just the ideas. Because part of what we did in putting this together was begin by identifying why it is we have a problem with social security. And one of the pieces—and baby boomers are not the answers to that because obviously we’ve known they were coming for a long time. There is no surprise in the impact of the baby boomers on social security projection.

The first is life expectancy growing, as I pointed out on the first slide, and a number of countries recognizing that this is an ongoing issue, want to have automatic adjustments for life expectancy. And that seemed to us to be a very good idea, but we wanted to do something rather different. It was a good idea for one of the plans from the Bush commission. It is the way the system works in Sweden and a number of other countries, but in all of those cases what they want to do is cut annual benefits so that lifetime benefits don’t change. So the system goes on costing the same. We thought that was a mistake.

We think as we go on and people live longer your ability to work, your ability to enjoy working and your ability to be better off are going to be out there, so it’s not going to be a constant fraction of life expectancy we should expect people to work on. And if people are going to be retiring a bit earlier than that, then we need more money. So we proposed half of the increased cost coming from life expectancy on a year-by-year basis would be offset by reducing benefits and half would go by raising taxes. Having future payroll tax rate increases as part of the package is with a longstanding social security tradition. From the beginning of social security right through to 1990 there was always a future payroll tax rate increase on the books. It’s so much easier to legislate tomorrow’s tax rate increase rather than today’s. And of course, there was all sorts of posturing—“that’s not going to happen while I’m in Congress”—and occasionally the money wasn’t needed and they would delay the start of it, but they never took them away. It would be great to have something like that back again.

Since the last reform, there's been a dramatic increase in earnings inequality and we proposed two things to do about that. One is to raise the maximal earnings that is subject to the payroll tax, so we're back in roughly the same position relative to total earnings. We didn't even go all the way there—that we had back with the last reform. And secondly, a more progressive benefit formula as part of offsetting that.

The third element is the legacy costs. Now social security was extremely generous to our parents and grandparents. If it hadn't been for that, certainly old age assistance would have been vastly larger, and the living standards of the elderly would have been vastly lower. This was really something aimed at the whole country. And as a result the social security trust fund, as big as it is, is a lot smaller than it would have been if it hadn't been generous. So how do we want to share out that cost associated with history?

The first element is universal coverage. There is a huge number of state and local workers including all of those in Massachusetts, where I come from, who are outside of social security. They are not contributing the roughly 3-3.5 percentage points of the payroll tax that are really just making up for the interest we're not earning on the assets that are not there. And so there's no reason that state and local workers who had parents and grandparents—I think they all did, and a lot of them were covered by social security—should not bear a fair share of that. And secondly, when spreading this burden around, it seemed to us capping that 3 or 3 and a half percent that people are paying at the limit that makes sense for paying people benefits, the taxable earnings base, is not the fairest way to spread the cost. So we proposed to tack on a tax like the Medicare tax with no limit on the earnings base but only at 3 percent. You don't get benefits for it. You're just picking up your share for having been good to your parents and grandparents. Doing those two things and the other elements up above get us a long way toward solving the problem, but they don't get us all the way there. And so our proposal for the rest, think of it as political compromise, is whatever is left you split 50-50 between tax increases and benefit cuts, and you phase them in slowly over time as needed. Do all of that, with the kind of numbers we fed in, there's money available for the various groups for whom social security should be enlarged and not shrunk.

So what happens if we do that? Well the trust funds—these are the numbers back in the book. It's a couple of years out of date. It wouldn't look all that different. Instead of the trust fund tanking, it builds up faster and comes down dramatically of course as the baby boomers retire. But by phasing in all of the changes slowly, it turns around.

Now, right now as a political matter obviously individual accounts are dead. Nobody is going to stand up and say “this is a great time to drive the American workers into the stock market.” But if we don't do anything about social security and the reports of its problems get steadily worse as that running out of money day comes closer, they will be back. It's like a bad movie. Individual accounts as an idea keep coming back. And I want to leave with you a couple of points why that would be a disaster relative to the federal debt that this program is about. A lot of economists like individual accounts, but what they like is new taxes which we can feed into individual accounts as a way to raise

national savings and as a way to raise retirement benefits. But that isn't the way the political process, at least in recent times, works.

The plan put forward by President Bush had people eligible to shift their payroll taxes, part of it, into their individual account rather than go into the trust fund. And then later on they would make it up by getting smaller benefits. So that on an individual basis, the trust fund was more or less held safe relative to that diversion. But of course the diverted revenue comes long before the benefit offsets, and so as a result the social security trust fund hits zero a lot sooner than without individual accounts.

Well what do we do if that happens? Well nobody is going to say "then we'll cut all of these benefits a lot earlier. That's what we've accomplished with the individual accounts." So the typical proposal with individual accounts: tap the treasury to make up the gap. And some people would say, and of course, we'll take that out of everybody's favorite line in the federal budget: waste, fraud and abuse. If you think on the other hand, more plausibly, that it'll come out of additional borrowing, then of course we'll have more national debt outstanding to deal with. And these are numbers from the middle of the Bush administration, no stimulus in it, nothing like that. Let's look at how much different plans that have been evaluated by the office of the actuary would add to the federal debt relative to GDP by carrying out the plan.

And at the very bottom you see two plans, the late Bob Ball is the other one there, that don't have individual accounts. And by addressing the shortcomings, putting social security on a good trajectory, by 2050 they've knocked about 25 percent of GDP off the debt-to-GDP ratio. Now compared to Medicare that's peanuts, but I think 25 percent of GDP maybe counts as something worth paying attention to. If you look at all of the plans with individual accounts, they all require additional federal borrowing in order to make them work. And some of them would blow you away in the sense that that's more than we think the Federal government could borrow, all by itself, even if there were no other deficits.

So let's get on social security. Let's remember that the public is going to be very happy if we really fix it and stop people from worrying about it. And a New Yorker cartoon is the way I like to end these talks. A guy on a desert island—a little hard to read—says, "Forget about me, save social security."