

Comments on:
Saving Social Security
by Peter Diamond and Peter Orszag

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January 29, 2004

Goals of Social Security Reform Plans

- Restore long-term sustainable solvency.
- Do not destroy program in order to save it.
 - ◆ Two rationales for Social Security:
 - ◆ Forced “saving” plan (myopic people).
 - We would not let old people starve because they did not save anything for retirement.
 - ◆ Social safety net (redistribution).
 - ◆ “Destroying” Social Security means different things to different people.
- No accounting gimmicks or magic asterisks.

Things I Like About Diamond-Orszag Plan

- Restores long-term balance.
- Does not use gimmicks.
- Does not invest the trust fund in equities.
- Does not use general revenues, although an alternative would divert estate tax revenue.
- Makes the program (almost) universal by adding state and local government workers to the system.
- Makes some adjustment for increasing longevity, although not the adjustments that I would make.
- Improves safety net for low-income beneficiaries.

Another Important Goal for Social Security Reform

- **Increase saving** by moving toward more pre-funding of future retirement obligations.
 - ◆ We should not only be concerned about the financial condition of Social Security but also the size of the economy when we have an older population.
- In the Diamond-Orszag plan there is an increase in the trust fund in the short term but it is an approximately pay-as-you-go system in the long term.
 - ◆ Does the SS trust fund add to saving?
 - ◆ Not if policymakers offset larger trust fund with larger deficits in other budget accounts.
 - ◆ Social Security would not have any significant pre-funding in the long term.

Social Security Reform and Increasing Saving

- “The crucial retirement funding issues center on how to increase the amount of saving...” -- Alan Greenspan, congressional testimony on Social Security, January 1999.

<http://www.federalreserve.gov/boarddocs/testimony/1999/19990128.htm>

- “I believe, however, that focusing too narrowly on the Social Security funding question -- in isolation from the more fundamental economic challenge of an aging population -- risks muddling the problem and perhaps picking a wrong answer.... If we want to have a bigger GDP to divide among the elderly and the non-elderly in the future, the obvious thing to do is to save more now. -- Alice Rivlin, speech to Business Roundtable, April 1999.

<http://www.federalreserve.gov/boarddocs/speeches/1999/19990406.htm>

Another Important Goal for Social Security Reform

- **Restrain projected long-term growth of elderly entitlement spending.**
 - ◆ Recent projections by CBO (December 2003) suggest that, if unchecked, federal spending (as a share of GDP) could grow to unprecedented levels in the U.S..
 - ◆ High rates of taxation to pay for large increases in federal spending caused by entitlement programs would be detrimental to the economy.
- Relative to the size of the economy, the Diamond-Orszag plan primarily increases taxes and does not restrain total Social Security spending much.

Long-Term Paths for Primary Federal Spending

[Primary spending=total non-interest outlays]

(as a percent of GDP)

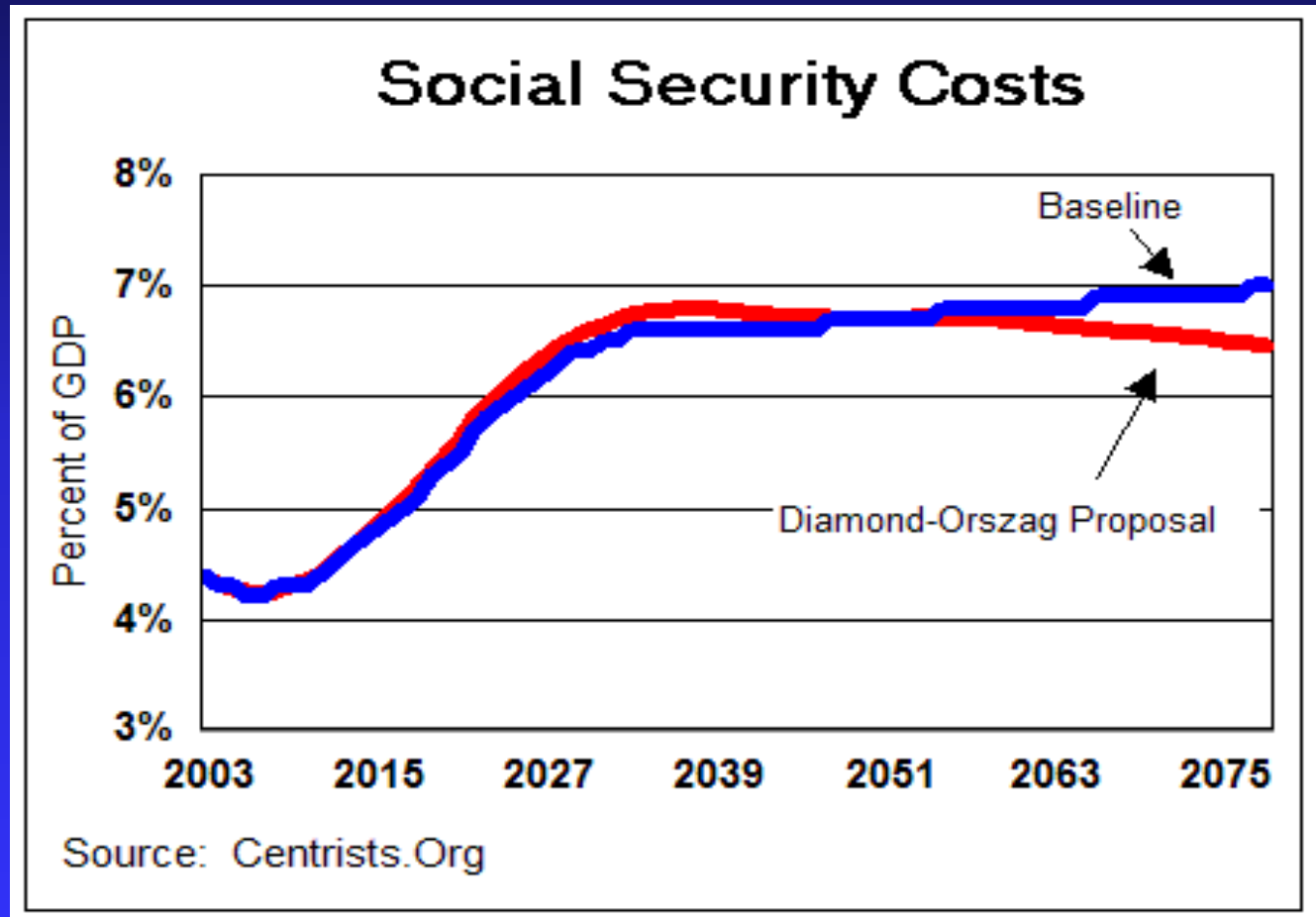
source: CBO

YEAR	2003 (actual)	2030	2050
<u>SCENERIO 1</u>			
SOCIAL SEC	4.3	5.9	6.3
HEALTH	4.0	11.5	21.3
DEFENSE	3.7	2.8	2.0
OTHER	6.5	4.3	3.4
TOTAL	18.5	24.5	32.9
<u>SCENERIO 2</u>			
SOCIAL SEC	4.3	5.9	6.2
HEALTH	4.0	8.4	11.5
DEFENSE	3.7	2.0	1.4
OTHER	6.5	4.5	4.2
TOTAL	18.5	20.8	23.4

Social Security Benefits

(as a percent of GDP)

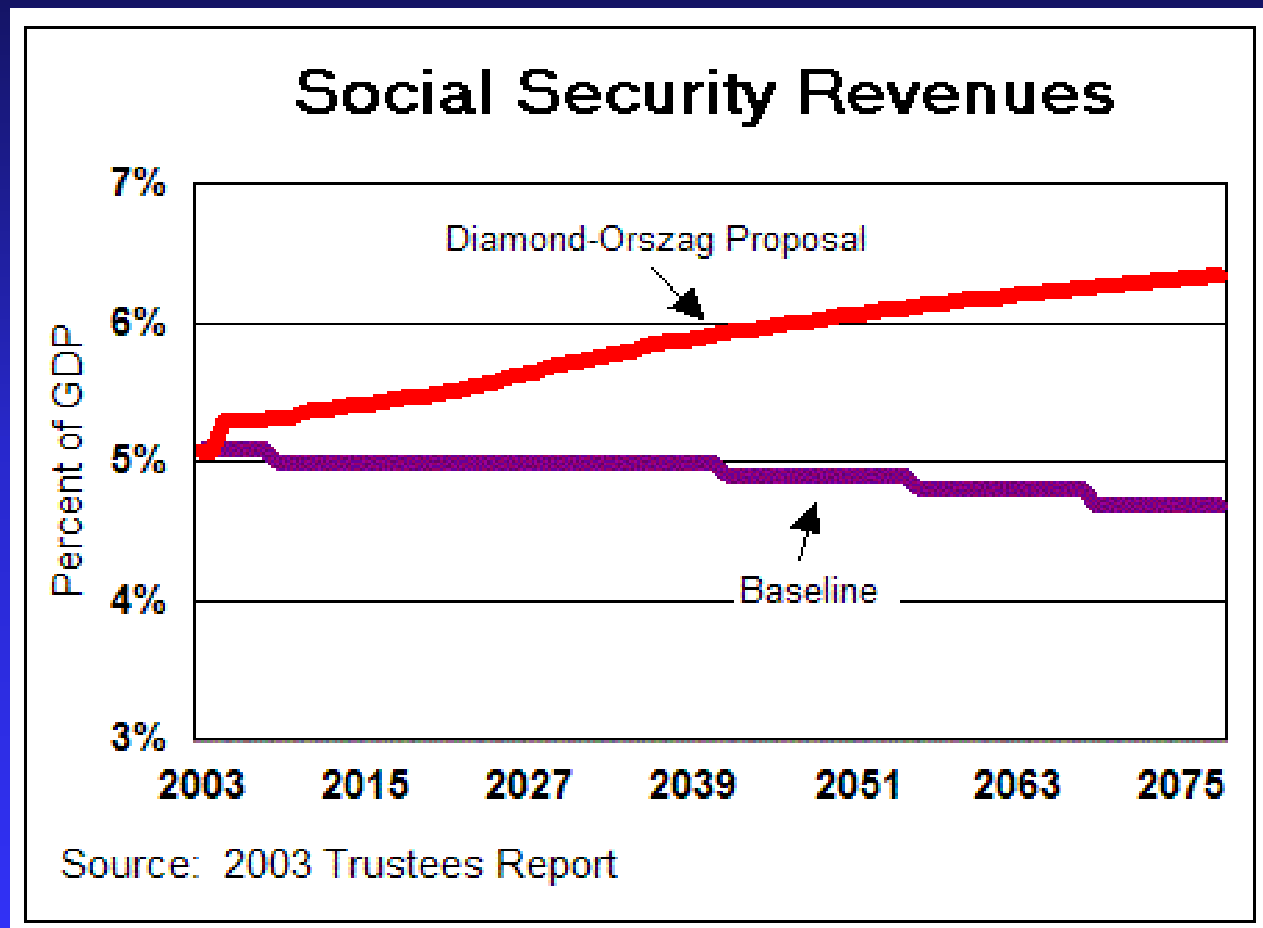
source: http://www.centrists.org/pages/2003/12/11_lemieux_wealth.html



Social Security Taxes

(as a percent of GDP)

source: http://www.centrists.org/pages/2003/12/11_lemieux_wealth.html



Summary

- There are many things to commend in the Diamond-Orszag proposal.
- However, it does not do enough to significantly address two important goals.
 - ◆ It does not move toward more of a pre-funded retirement system.
 - ◆ An individual account component can help here.
 - ◆ It does little to restrain government spending growth but instead mostly raises taxes.
 - ◆ This would be a particularly disastrous approach to addressing the bigger health entitlement problem.