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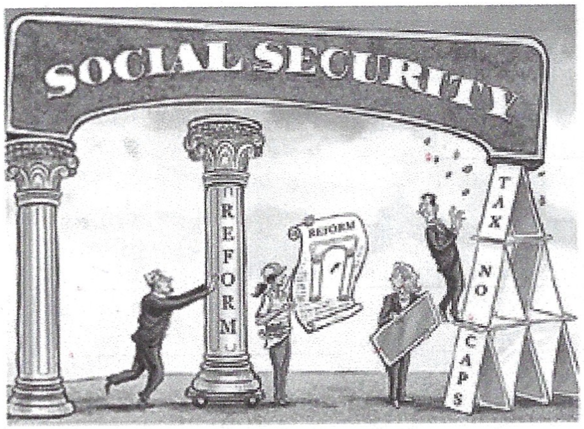
The bipartisan 1983 effort made the system solvent for half a century, largely thanks to a strong economy.



CHAD CROWE

How Reagan Saved Social Security

By Phil Gramm And Michael Solon

Note

Any proposal to deal with Social Security's pending insolvency should be based on an understanding of history—why the 1977 Social Security reform failed in only five years while the 1983 reform bought 50 years of solvency. The 1977 reform failed as real wages declined, prices spiraled and the economy stagnated. The 1983 reform succeeded largely because of a strong economy: The inflation rate plummeted, ushering in decades of price stability, and real wages rose, producing about a quarter-century of strong economic growth.

Note

Any Social Security reform based on raising the Social Security tax rate and expanding income subject to the tax would push millions of taxpayers to a cumulative marginal rate of more than 50%. That would cripple an economy in which real wages are already stagnant and gross domestic product is growing at less than 2% a year—ultimately failing to provide Social Security solvency.

President Franklin D. Roosevelt said in 1935 that Social Security would be "compulsory contributory annuities which in time will establish a self-supporting system for those now young and for future generations." Senate Finance Committee Chairman Pat Harrison (D., Miss.) promised Social Security's "annuity system will give to the worker the satisfaction of knowing that he himself is providing for his old age."

Note

Two years later, Roosevelt's Justice Department argued before the Supreme Court that Social Security taxes "are true taxes, their purpose being simply to raise revenue. . . . The proceeds are paid unrestricted into the Treasury as internal revenue collections, available for general support of the Government. . . . A taxpayer has no standing to question the propriety of any expenditures from the Federal Treasury."

Huge

With Social Security tax collections initially dwarfing benefit payments, government pillaged the notional trust fund, adding benefits and beneficiaries. Congress increased benefit payments for retirees and expanded coverage to spouses and dependents. Inflation adjustments triggered election-year bidding wars. After World War II, repeated legislative increases expanded inflation-adjusted Social Security benefits for a worker with average lifetime earnings by 442%, 28% faster than per capita GDP growth.

Note

In 1972 the Nixon administration proposed automatically indexing the buildup of Social Security benefits by nominal wages prior to retirement and by inflation after retirement, significantly expanding benefits. But a legislative drafting error indexed

Note

benefits for both nominal wages and inflation, ~~in~~ the process doublecounting the effect of inflation. Social Security benefits spending spiked by an extra 21%, the nominal trust fund balance plummeted by a third, and the trust fund faced insolvency in five years.

Note

The 1977 Social Security reform made two major changes: It eliminated the double-counting of inflation in indexing Social Security benefits (although it continued to index the buildup of benefits before retirement by wage growth rather than prices). It also raised the payroll tax rate (including both Social Security and Medicare) by 14% and the income level subject to the Social Security tax by 96% from 1977-82.

When signing the 1977 reforms, President Jimmy Carter said that the rescue would "solve both the shortterm and long-term problems in the Social Security system through the end of the 20th century." Instead, by 1981, Social Security trustees warned that the Old-Age and Survivors Insurance Trust Fund would "be unable to make benefit payments on time beginning in the latter half of 1982."

The 1983 Ronald Reagan-Tip O'Neill Social Security rescue succeeded in large part because by 1983 a committed Federal Reserve had broken the back of inflation and the Reagan program had spawned a recovery that lasted for a quarter of a century. Inflation was checked for nearly 40 years, and from 1983 until the beginning of the subprime crisis, real GDP grew on average by 3.4% a year.

Note

The Reagan-O'Neill reform still stands as a testament to bipartisanship at its best. The Reagan budget and the Social Security rescue package terminated or significantly reformed a series of unearned benefits such as the minimum benefit, the death benefit and the adult-student benefit, and, through an amendment offered by Rep. Jake Pickle (D., Texas) and supported by the vast majority of Republicans, it raised the full retirement age from 65 to 67. It also accelerated scheduled Social Security taxrate increases, incorporating ideas previously recommended by the Jimmy Carter-Joseph Califano Advisory Council on Social Security. This bipartisan effort averted an immedi--ate crisis and stabilized Social Security's finances for a half-century.

Note

So long as the Social Security system runs on a pay-as-you-go basis with no real investments to support benefits, it will never be solvent on a long-term basis. The Roosevelt administration could have invested the portion of annual Social Security taxes not required to fund the small early-year benefits in a trust fund that was owned by the people who paid Social Security taxes. Had the government adopted such a system from the beginning, investing 70% in a broad-based stock portfolio like the modern S&P 500 and 30% in investment- grade private bonds, the trust fund in 1977 would have held $209 billion in real assets rather than $36 billion of government IOUs. Had the surpluses generated by the bipartisan reforms of 1983 been invested in a similar investment mix, the Social Security trust fund would have $14.1 trillion in real assets today rather than a government IOU for $2.6 trillion.

Note Note Note

Except in the immediate recovery from the pandemic, annual real GDP growth has cleared 3% only once since 2008. With economic growth during that period one-third less than the previous postwar average, the Social Security Trustees' estimated insolvency date has moved up from 2042 to 2032. Our historical experience suggests that a Social Security reform relying on raising tax rates and eliminating the income cap would hobble the economy and fail to achieve long-term solvency. Note

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