

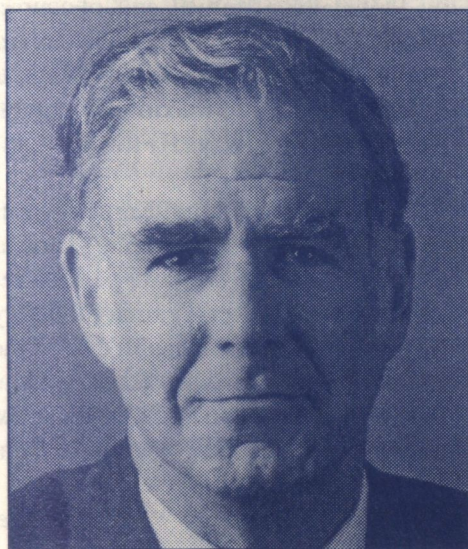
NTA Forum

Perspectives, Ideas and News from the National Tax Association

Number 26, Summer 1996

The Myths of Social Security Crisis: Behind the Privatization Push

By Henry J. Aaron
Senior Fellow, Economic Studies
The Brookings Institution



Plan to Attend
**89th Annual
Conference on Taxation**
November 10-12, 1996
Boston Park Plaza
Boston, Massachusetts

No presidential candidate wants to talk about Social Security during the campaign. But events are conspiring to force them to do just that. Three factions on a usually obscure governmental commission, the Advisory Council on Social Security, are about to call for reductions of various sizes in benefits for future retirees.

One of these factions will propose gradually ending Social Security as we know it. The newest presidential aspirant, Richard Lamm, has made a career of bemoaning the excessive costs of programs for the elderly. And brokerage houses and mutual funds, lusting after lucrative customers, are pouring millions into a campaign to convince Congress and the president to privatize Social Security. The critics say that Social Security is broke and beyond fixing. Are they right?

As the debate within the Advisory Council and the vigorous lobbying of financial companies make clear, larger debate is now under way. That debate is about whether to fix Social Security or to replace it with mandatory private savings accounts. Though badly overused, the term "vitally important" fairly describes this debate. Unfortunately, sensible debate is almost impossible because the debate is shrouded in myths and misrepresentations, repeated so often that many people now assume they are true.

Myth 1

Social Security is in crisis.

Well, let's see. Social Security revenues now exceed outlays by more than \$65 billion a year. This annual surplus is projected to more than double in the next decade. The Social Security trust funds are projected to keep growing for 16 years. The system is projected to be in overall surplus for the next 30 years and current financing is likely to cover currently promised benefits for 34 years. Only later are projected revenues and accumulated reserves insufficient to pay legislated benefits.

A problem? Well, yes, because revenues will probably not cover benefits for 75 years, the planning horizon legislators use to determine whether Social Security is solvent in the long run. The problems are real and certainly deserve attention, the sooner, the better. Taxes will have to be increased, benefits cut, or both. But there is no need for political palpitations and heavy breathing. The total projected increase in the cost of Social Security, measured as a share of gross domestic product, is less than the decline in defense spending since 1990. Can a problem that does not become immediate for a third of a century be a "crisis"? In a pig's eye.

Myth 2

Social Security is part of the current deficit problem.

How can a program that this year is generating \$65 billion more in revenue than it spends be a part of the current deficit problem? Obviously, it can't. The Social Security program, because it runs a surplus, actually reduces the deficit. Repeal Social Security today and next year's budget deficit would rise by \$75 billion, from a projected \$144 billion to \$209 billion. Repeal Social Security today and the national debt would be nearly \$700 billion larger in 2002 than it is projected to be. Balanc-

Continued on page 6

NTA Forum

Number 26, Summer 1996

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NTA Forum is a newsletter containing viewpoints, ideas and news from the National Tax Association, a nonpolitical, non-partisan, nonprofit organization devoted to advancing understanding of the theory and practice of taxation at all levels of government.

Expressions of opinion contained in *NTA Forum* are solely those of the authors and do not necessarily reflect those of the Association, its officers, or other members.

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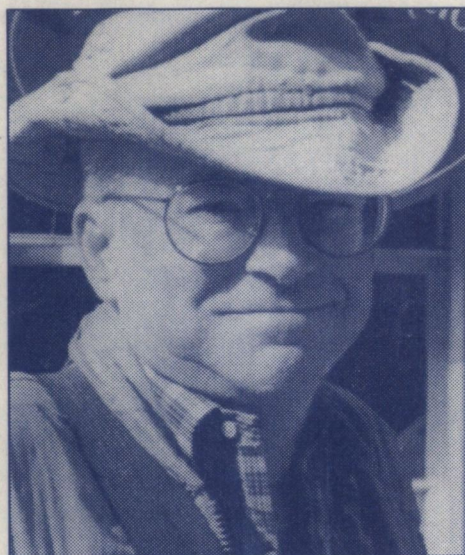
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The NTA office gets phone calls every day asking for all kinds of tax information—from the latest study on state tax earmarking or enterprise zones to the flat tax and unfunded mandates. The calls come from across the country, from journalists, advocacy groups, students, and government officials. Even when we think we have a pretty good response, we go to our membership list and refer the caller to the nation's experts. How often it was so easy to say, "Call Steve Gold."

NTA Board member, author of the inaugural issue of the *NTA Forum*, frequent contributor to the *National Tax Journal*, program chair of the Annual Conference on Taxation, chair of NTA committees, Steve was everyone's state and local finance economist—promoter of other people and their ideas that he

thought demanded attention—so even-handed and intellectually straight that he could fit in just as easily on a dissertation committee as on a citizens forum on tax-exempt property—an economist who was comfortable with the no-nonsense advocacy community. And, friend and colleague to people all over the country. Even people who never met Steve except by telephone considered him a friend.

A month ago, Steve died of cancer. During that battle, when the doctors told him that on the following day they were going to try a procedure that would cause him to lose his ability to speak for some time, he got on the phone and called people all over America. To the end, he never lost his smile or his wit.

And, although they probably won't know it, people who never met Steve will miss him—the low-income taxpayer for whom he was such an advocate, the Philadelphia Phillies, and, of course, the Mileage-plus program at United (Steve once held a brown-bag seminar at NCSL on how to maximize frequent flyer miles . . . "always fly through Chicago").

To you, his NTA colleagues—your phone is going to start ringing. Time to get up to speed on welfare, pension reform, circuit breakers, gaming industry taxes, school finance, health care in the states, quarterly revenue trends, truth in budgeting laws, state EICs, nexus rules, and, just in case you get asked to Denver, frequent-flyer programs.

Bob Ebel

Please Note

For your convenience in paying membership and registration fees, NTA now accepts Master Card and VISA. You may fax credit card payments to NTA at 703/237-7662.

Two Conferences for the Price of One!

This year, NTA is doing something new and exciting—and a fantastic bonus for NTA members.

You have received the preliminary program for the 89th Annual Conference on Taxation, being held at the Boston Park Plaza on November 10-12, for which Program Chair Therese McGuire has put together first-rate sessions on critical and often controversial issues—social security, state pension plans, national health insurance, treatment of nonprofits, taxes and the poor, fiscal crisis of the cities, and tax policy and spending behavior. There will be sessions on topics as diverse as New England tax history and South African tax politics. The *Program at a Glance* is on page 3.

On Sunday, November 10 at 1:00 P.M., **George Break** will receive NTA's prestigious **Daniel M. Holland Medal** for distinguished lifetime contributions to the study of public finance. **Don Fullerton** will make remarks and **NTA President Emil M. Sunley** will make the presentation. On Tuesday, November 12, **Martin Feldstein** will deliver the Conference Luncheon address. There will also be receptions on Sunday and Monday evenings.

Now for the deal—By registering for the Annual Conference, you may also attend the conference on the *Taxation of Telecommunications and Electronic Commerce*, which will take place at the same hotel on November 11-12, sponsored jointly by NTA with the Federation of Tax Administrators, National Conference of State Legislatures, and Multistate Tax Commission. The program for this conference appears on page 4. Whereas the Annual Conference focuses on the range of today's key public finance issues, the telecommunications and electronic commerce conference looks at what is perhaps the single hottest issue of the decade.

As a public finance expert, you have to know about this topic.

You may register using either the form in the preliminary program or the one on page 7. *Please note that NTA now accepts Master Card and VISA.*

The only way you can lose on this deal is by staying at home.

89TH ANNUAL CONFERENCE ON TAXATION BOSTON PARK PLAZA HOTEL, NOVEMBER 10-12, 1996

PROGRAM AT A GLANCE

SUNDAY NOVEMBER 10

General Session

- ☐ Social Security Reform

Concurrent Sessions

- ☐ Decentralization in an Economic Union: Perspectives from the NAFTA Countries
- ☐ Alternative Models of Taxation and Saving Behavior
- ☐ Health Reform: Beyond National Insurance
- ☐ Annual Meeting of the National Tax Association
Daniel M. Holland Medal Presentation to George Break
1996 Outstanding Doctoral Dissertation Winner
Presidential Address—Emil M. Sunley

MONDAY NOVEMBER 11

General Sessions

- ☐ Fundamental Tax Reform
- ☐ Tax History: A Broad View and New England Perspectives

Concurrent Sessions

- ☐ The Fiscal Status of Cities
- ☐ Policy Issues Concerning Private Pensions and State and Local Pension Plans
- ☐ Taxes, Public Spending, and the Nonprofit Sector
- ☐ New Trends in Environmental Taxation and Regulation
- ☐ State and Local Fiscal Policy by Referendum and Initiative
- ☐ Outstanding 1996 Dissertation Presentation
- ☐ NTA Committee Meetings

TUESDAY NOVEMBER 12

Annual Conference Luncheon—Speaker: Martin Feldstein

Concurrent Sessions

- ☐ Sales Taxes and Electronic Commerce
- ☐ Methods for State Tax Policy Analysis: Incidence and Revenue Responsiveness
- ☐ International Taxation
- ☐ Tax Expenditures
- ☐ Taxation and the Low-Income Population
- ☐ Fiscal Policy Research Needs and Resources in State Government
- ☐ Serrano after 25 Years: Are America's Schools Better and Property Taxes Fairer?
- ☐ Taxation and Individual Portfolio Behavior
- ☐ Issues in South African Tax Policy
- ☐ NTA Committee Meetings

TAXATION OF TELECOMMUNICATIONS AND ELECTRONIC COMMERCE

A CONFERENCE CO-SPONSORED BY

FEDERATION OF TAX ADMINISTRATORS
MULTISTATE TAX COMMISSION
National Conference of State Legislatures
National Tax Association

November 11-12, 1996
Boston Park Plaza Hotel

MONDAY, NOVEMBER 11, 1996

8:30-9:00 AM

Welcome: Gary Cornia, Associate Dean, Marriott School of Management, Brigham Young University
Keynote: The Honorable Carol Fukunaga, Chair, Communications and Public Utilities Committee, Hawaii Senate

9:00-11:00 AM

INDUSTRY AND GOVERNMENTAL DEVELOPMENTS

Moderator: Clarence M. Brasfield, Director of Corporate Taxes, BellSouth Corporation, Atlanta

Presenters:

Richard McHugh, Policy Research Center, Georgia State University—What Is Going on in the Industry?

John C. Klensin, Senior Data Architect, MCI Communications Corporation, Boston—Federal Telecommunications Act of 1996

Jacqueline Wong, U.S. Department of the Treasury—U.S. Treasury Discussion Paper on Taxation and Information Technology

Discussant: Berge Ayvazian, Executive Vice President, Yankee Group, Boston

11:15 AM-Noon

REVIEW OF THE STATES

Moderator: Gerald D. Bair, Director, Iowa Department of Revenue

Presenter: Deborah R. Bierbaum, Deputy Commissioner, New York State Department of Taxation and Finance

12:00-1:30 PM LUNCH

1:30-2:30

TAX POLICY AND ELECTRONIC COMMERCE

Moderator: Carol Bessey, Deputy Director for Tax Policy, Ohio Department of Taxation

Presenter: Kurt Zorn, Professor, School of Public and Environmental Affairs, Indiana University

Discussants:

O. William Asplund, Staff, Utah Legislature
Kathleen Lusk, Senior Manager-Tax, Ernst & Young, Kansas City, MO

3:00-4:00 PM

LEGAL ISSUES SURROUNDING TELECOMMUNICATIONS TAXATION

Moderator: The Honorable Al Knight (Alabama), Vice Chair, NCSL Commerce and Communications Committee

Presenter: R. Scot Grierson, Manager, KPMG Peat Marwick, Costa Mesa, CA

Discussants:

The Honorable David O. Nething, Chair, Appropriations Committee, North Dakota Senate
Paull Mines, General Counsel, Multistate Tax Commission

4:00-5:00 PM

CORPORATE TAX

Moderator: Patrick Nugent, Director, Tax Legislative Affairs, MCI Communications Corporation, Washington, DC

Presenter: J. William McArthur, President and Executive Director, Committee on State Taxation

Discussants:

Scott Clark, Associate Tax Counsel, GTE Service Corporation
James Peters, Consultant to the California Franchise Tax Board

6:00-7:30 RECEPTION WITH NATIONAL TAX ASSOCIATION

Hosted by Lincoln Institute of Land Policy

TUESDAY, NOVEMBER 12, 1996

8:30-10:00 AM

SALES TAX

Moderator: Billy Hamilton, Chief Deputy Comptroller, State of Texas

Presenter: Matthew Murray, Professor of Economics, University of Tennessee

Discussants:

Ernest J. Dronenburg, Jr., Member, California State Board of Equalization
James R. Eads, Senior Attorney, AT&T, Atlanta
Bruce Reid, Director, Excise and Property Tax, Microsoft Corporation, Redmond, WA

Survey on Tax Reform

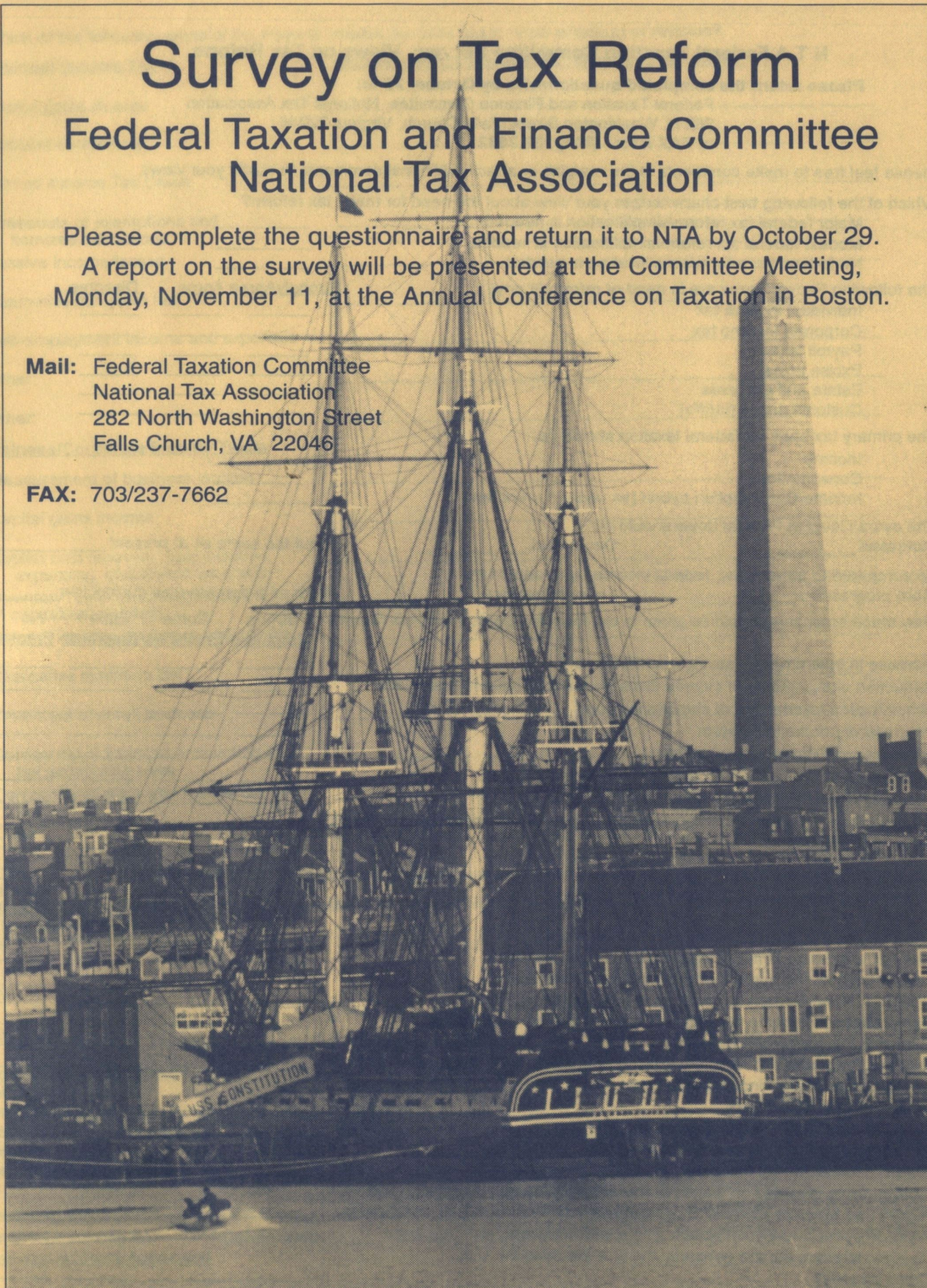
Federal Taxation and Finance Committee National Tax Association

Please complete the questionnaire and return it to NTA by October 29.

A report on the survey will be presented at the Committee Meeting,
Monday, November 11, at the Annual Conference on Taxation in Boston.

Mail: Federal Taxation Committee
National Tax Association
282 North Washington Street
Falls Church, VA 22046

FAX: 703/237-7662



U.S.S. CONSTITUTION / BUNKER HILL MONUMENT

N T A Federal Taxation Committee Survey: Views on Tax Reform

Please return the completed questionnaire by October 29 to:

Federal Taxation and Finance Committee, National Tax Association
282 N. Washington Street, Falls Church, Virginia 22046
or FAX it to: (703) 237-7662

Please feel free to make comments in the margins or attach additional comments to clarify your views.

- 1 . Which of the following best characterizes your view about the need for major tax reform?

Major federal tax reform/simplification is needed. _____

Modest federal tax reform/simplification is needed. _____

No federal tax reform/simplification is needed. _____

- 2 . The following Federal taxes are in need of reform (if any):

Strongly Agree Agree Disagree

Individual income tax _____

Corporate income tax _____

Payroll taxes _____

Excise taxes _____

Estate and gift taxes _____

Customs duties (tariffs) _____

- 3 . The primary tax base for federal taxation should be:

Income _____

Consumption _____

Income/Consumption hybrid (as under current law) _____

- 4 . The overall level of Federal taxes should be:

Increased _____

Decreased _____

About the same as at present _____

- 5 . As compared to current law, federal income taxes should be:

More progressive _____

Less progressive _____

About as progressive as current law _____

- 6 . How much emphasis should be given to the following goals in any tax reform?

Strong Some Little No
Emphasis Emphasis Emphasis Emphasis

Increase in incentives for saving and investment _____

Reduction of the effects of income taxes on private economic decisions _____

Simplification / Reduction of compliance costs _____

Progressivity of the tax system _____

Introduction of flatter, lower tax rates _____

Broadening of the tax base ("closing of loopholes") _____

The total level of Federal tax revenues _____

Integration of individual & corporate income taxes (i.e., elimination of double tax) _____

Other (specify): _____

- 7 . What is your general view of how each of the following tax reform proposals compares to current law?

(See the attached description of the proposals)

Much more More Less Much less
Desirable Desirable Desirable Desirable

The Flat Tax (i.e. Armey/Shelby and Hall-Rabushka) _____

Flat Tax with some itemized deductions (e.g., charitable contributions and home mortgage interest expenses) _____

USA Tax (Nunn-Domenici), consumed income tax _____

Comprehensive income tax with broad base and few deductions _____

Gephardt Progressive Income Tax _____

Gibbons Proposal (VAT with low-income refundable VAT credit plus income tax for high-income taxpayers) _____

National Retail Sales Tax _____

Credit-invoice Value Added Tax (European type) _____

Subtraction method Value Added Tax (BTT) _____

Bradford X-Tax (a Hall-Rabushka type business tax with progressive tax rates on wages at the individual level) _____

Return free systems where IRS computes tax _____

PAYE (Pay-As-You-Earn) System where withheld taxes on wages, interest, etc are generally the final tax as in the U.K. _____

Other (specify): _____

6 . Which of the following areas of the Federal income tax code are in need of reform or revision?

Individual Income Tax

Specific Change Needed (i.e., simplify X, reduce Y)

Capital gains income _____

Itemized deductions _____

Earned Income Tax Credit _____

Phaseouts of exemptions and itemized deductions _____

Passive income/losses _____

Alternative minimum tax _____

Self-employment income and expenses _____

Other: _____

Other: _____

Business/Corporate Income Taxes

Measurement of business income _____

Capital gains income _____

Capital cost recovery (depreciation, expensing, investment tax credit) _____

Inventory rules (including inventory capitalization rules) _____

Foreign income, expenses and credits _____

Alternative minimum tax _____

Treatment of small business _____

Conformity of financial accounting and tax accounting rules _____

Conformity of state and federal tax rules _____

Other: _____

Other: _____

7 . What are the most important changes needed in tax administration by the IRS and the Treasury Department? (i.e., regulations, forms, etc)

1.

2.

3.

Respondent information:

Employment:

Federal government _____	Business _____	Academic _____
State & local government _____	Self-employed _____	Retired _____

Profession:

Accountant and related _____	Lawyer _____	Economist _____	Other (specify) _____
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Age: Under 31 _____	31-40 _____	41-50 _____	51-60 _____	Over 60 _____
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Highest degree: BA,BS _____	MA,MS _____	MBA,CPA _____	PhD/LLD _____	JD/LLB _____	Other _____
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Year of Highest Degree: Before 1960 _____	1960-69 _____	1970-79 _____	1980-89 _____	1990+ _____
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Name and address (optional)

Brief Description of Some Recent Tax Reform Proposals

The Flat Tax (Armey/Shelby based on Hall-Rabushka): The tax base would be consumption rather than income. Businesses and individuals would pay tax at the same flat rate of 17% (20% in the first two years). Individuals would be taxed on wage and pension income. There would be no deductions, but the following exemptions would apply: \$21,400 for married couples filing jointly and \$5,000 for each dependent. Businesses would be taxed on receipts less purchases from other firms (including capital goods), wages and pension contributions. Fringe benefits would be taxed at the business level. The proposal can be viewed as a subtraction method VAT with wages taxed at the individual level. The Armey/Shelby proposal also would repeal the Gift and Estate taxes.

USA Tax (Nunn-Domenici): Income taxes would be replaced with two consumption based taxes. Individuals would pay tax at graduated rates (initially 19% to 40%, eventually 8% to 40%) on consumed income, calculated as gross income less net additions to saving, personal exemptions and family allowances, and deductions for charity and mortgage interest. Family living allowances would be \$7,400 for joint returns and personal exemptions would be \$2,550. Businesses would be taxed at an 11% rate on gross receipts less purchases from other firms (i.e., a subtraction method VAT). The employee and employer portions of the payroll tax would be creditable against the individual and business taxes respectively. The proposal is intended to be revenue neutral and approximately as progressive as current law.

Gephardt Progressive Income Tax: Individuals would be taxed on a comprehensive measure of income at 10% to 34% rates with capital gains taxed at the same rates as other income. State and local bond interest, health insurance, pension contributions and other fringe benefits would be taxable. Exemptions would be \$8,350 for married couples filing jointly plus \$2,750 for each family member. All deductions would be repealed except for the mortgage interest deduction. A \$50 billion reduction in corporate welfare would be used to reduce the tax rates on smaller corporations.

Gibbons Proposal: This proposal would levy a broad-based 20% subtraction-method VAT as a replacement for the corporate income tax, most of the individual income tax, and the employee portion of payroll taxes. A 17% surtax on income in excess of \$75,000 and a refundable VAT credit for households with incomes less than \$30,000 are designed to achieve distributional neutrality.

National Retail Sales Tax: A national sales tax on final sales by retail businesses to consumers would replace current corporate and individual income taxes. Senator Lugar's proposal would impose a 17% sales tax rate, while Senator Schaefer's proposal would impose a 15% rate. Some proposals call for the tax to be administered by the states.

Credit Invoice Value Added Tax: Businesses pay tax on gross receipts, but claim a credit for VAT taxes paid by suppliers of the goods and services they purchase.

Subtraction Method Value Added Tax (Business Transfer Tax) Businesses pay tax on receipts less purchases from other businesses, including capital goods.

Bradford X-Tax: Businesses pay tax on receipts less purchases from other businesses and wages. Individuals would be taxed on wages and salaries at graduated rates. The proposal can be viewed as a subtraction method VAT with wages taxed at the individual level.

Pay-As-You-Earn Systems: Withheld tax is treated as the final tax on wages, interest, dividends, pensions and certain other types of income, substantially reducing the number of taxpayers required to file tax returns. Such a system permits only limited deductions or credits through the tax system and requires some mechanism to deal with changes in family status and income level.

10:30-Noon

PROPERTY TAX

Moderator: *Hal Holmquist*, Manager, Property Tax, Sprint Corporation, Shawnee Mission, KS

Presenter: *Joan Youngman*, Senior Fellow, Lincoln Institute of Land Policy

Discussants:

Walter Nagel, Vice President for Consumption and Property Taxation, MCI Communications Corporation, Washington, DC

Catherine Lang-Morrissey, Nebraska Property Tax Administrator

Warren E. Tolman, Senate Co-Chair, Massachusetts Joint Committee on Taxation

Noon-1:30 PM LUNCHEON WITH NTA ANNUAL CONFERENCE

Speaker: *Martin Feldstein*

1:30-2:30 PM

FRANCHISE FEES

Moderator: *Steve Riley*, Tax Director, Time Warner, Englewood CO

Presenter: *Robert Bland*, Professor of Public Administration, University of North Texas

Discussants:

Andy Ottinger, Senior Tax Counsel, US West, Denver

Robert Geppert, National Tax Director, Telecommunications, KPMG Peat Marwick, Denver

Myra Jones, Chair, City, County and Local Affairs, Arkansas House of Representatives

3:00-4:30 PM

TAX POLITICS

Moderator: *Eng Braun*, Administrator, Research and Analysis, Wisconsin Revenue Department

Presenters:

Larry H. Fuchs, Executive Director, Florida Department of Revenue-Telecommunications Taxes in Florida

Mark D. Bugher, Secretary, Wisconsin Revenue Department-Telecommunications Taxes in Wisconsin

Discussant: *Richard Varn*, Director of Telecommunications, University of Northern Iowa (formerly Iowa Senate)

4:30-5:30 PM

WRAP-UP OF CONFERENCE FINDINGS

What Has Been Learned and Where Do We Go from Here?

Moderator: *Harley T. Duncan*, Executive Director, Federation of Tax Administrators

Remarks: *Walter Hellerstein*, Professor of Law, University of Georgia; Of Counsel, Sutherland, Asbill & Brennan

Participant Discussion

PROGRAM COMMITTEE

Gary Cornia, Brigham Young University, *Chair*
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Robert D. Ebel, National Tax Association
Hal Holmquist, Sprint Corporation
Michael Mazerov, Multistate Tax Commission
Patrick Nugent, MCI Communications Corporation
Steve Riley, Time Warner
Chris Zimmerman, National Conference of State Legislatures

For NTA Registration Form, see page 7.

For further information, call Joan Casey at NTA, 703/237-7660.



Martin Feldstein Is NTA Luncheon Speaker

At the Annual Conference on Taxation luncheon on Tuesday, November 12, Martin Feldstein will address NTA on the subject of "Revenue Estimating for Tax Policy."

Dr. Feldstein is George F. Baker Professor of Economics at Harvard University and President of the National Bureau of Economic Research.

He is a former Chairman of the Council of Economic Advisers and was President Ronald Reagan's chief economic adviser.

The Myths of Social Security, *continued from page 1*

ing the budget by 2002, the zero-deficit target year according to bipartisan consensus, would require over \$100 billion more in spending cuts or tax increases were Social Security not on the books.

Myth 3

The Social Security trust fund is a myth. The money has all been spent and it won't be there when we need it.

This statement contains an element of truth—it points to a genuine problem with government financing—but it directs attention away from the real problem, which lies outside of the Social Security system.

Each dollar of Social Security reserves is invested in special Treasury securities. One way to see the value of these assets is to imagine yourself the financial manager of a large insurance company. You are in charge of a portfolio that includes U.S. government bonds like those held in the trust fund. Far from regarding these government bonds as mythical, you would recognize them as the safest asset in your portfolio. You can sell at any time or hold to maturity for redemption at face value, without the slightest default. Anyone who suggested that such assets were a "myth" would be dismissed as a financial ignoramus. As portfolio manager, you might take criticism for being unnecessarily conservative and sacrificing returns you could earn by investing in riskier securities, such as stocks or corporate bonds. But your holdings of government bonds would be seen for what they are—the most dependable asset in your portfolio.

In one important sense the trust fund has been "spent." So have the life insurance premiums that were invested in government securities. In both cases, saving that might have gone for investment in new buildings or machines goes instead to pay for current expenditures of the federal government. Because saving was spent on current public consumption, not on real capital assets, the

nation lost the added future production that real capital assets could have produced. But the diversion did not occur because Social Security is poorly managed or because private saving was unwise. It occurred because the federal government does not collect enough in ordinary taxes to pay for expenditures on activities other than Social Security.

There is a real problem here, and it's exacerbated by the anemic level of national saving. If people and businesses in the United States were heavy savers, modest government deficits outside Social Security would be no problem.

Myth 4

Allowing people to invest privately what they now pay in Social Security taxes—that is, "privatizing" Social Security—would raise saving, boost economic growth and increase retirement incomes.

Social Security reserves are invested in Treasury securities that yield the same interest as the Treasury pays on publicly issued bonds. The return on these bonds is projected to exceed inflation by 2.3 percent annually. That return looks pretty modest compared with yields on private stocks, which have exceeded inflation by about 7 percent on the average for several decades. To supporters of privatization the solution is obvious: Let workers and their employers invest in these better paying private securities rather than send it to the government in payroll taxes. The economy will gain because of the increased return. And workers will earn much larger pensions or, at least, pay less for the pensions they have been promised.

Sounds terrific, right? Well, not quite. Eighty-four percent of Social Security revenues pay for current benefits. Few people are willing to slash benefits of the currently retired, who are in no position to adjust to reductions in benefits they have had every right to expect. If we are going to maintain pensions to the current beneficiaries, only one-sixth of current payroll taxes is available to go into private securities.

Even that switch will not do what is claimed for it. Suppose that payroll taxes were cut by just the excess of current revenue over current outlays—about \$65 billion a year—and that people increased their purchases in private securities by that amount. In that event, the federal government would have to borrow an additional \$65 billion from private savers. As a result, \$65 billion in private savings that otherwise would have paid for private investment will go to finance government operations. The \$65 billion in reduced payroll taxes shifted to private assets would just offset the diversion of private savings into government bonds.

What would be the net effect of this diversion? Private investors would hold \$65 billion less of private assets and \$65 billion more of government bonds. Resources available for private investment are unchanged. If investment does not change, the capital stock available to the private economy will be the same. And, so will economic growth. There is little reason to think that this swap will have any effect on economic growth whatsoever.

But there is more. All plans to privatize Social Security come bundled with tax increases. Supporters of privatization almost never come clean on this stubborn fact. Proposing higher taxes is not a good way to win friends these days. Tax increases are necessary to make privatization work, because payroll tax revenues are not adequate to pay both for benefits today and for the build-up of reserves in new personal accounts. These added taxes reduce consumption. That leaves more of current production for investment in the United States or abroad.

If Congress wants to assure Social Security beneficiaries the same high returns on Social Security reserves that private securities yield, it need only instruct the managers of the trust funds to invest Social Security reserves in passively managed index funds containing private stocks and bonds. Presto! All of the so-called gains of privatization would accrue to Social Security beneficiaries.

Myth 5

Social Security is the third rail of American politics—touch it and you die.

Social Security has been the subject of major legislation three times in the past two decades. In each case benefits were cut. In 1977, Congress scaled back benefits about 20 percent to correct legislative mistakes made five years earlier. In 1983, Congress cut benefits again by raising the age at which unreduced benefits are paid and imposed income taxes on some Social Security benefits. And again in 1993, Congress cut benefits, this time by increasing the proportion of benefits subject to the personal income tax.

Meanwhile, chest-thumping members of Congress and febrile journalists brag of their own courage in daring to call for cutbacks in Social Security. With macho fanfare, they call on all to watch them grab this "third rail"—and somehow not one of them fries.

The truth is that talking about scaling back Social Security is politically chic. One reason is sensible: Most people know about the long-term deficit in Social Security and want to restore the system to financial health. Most acknowledge that some reduction in benefits is necessary—by delaying eligibility, by cutting benefits, or by subjecting Social Security benefits to the same tax rules that apply to private pensions.

Another reason is more political: The Social Security system is the largest government program of income redistribution in the United States. Early in the next century, high-wage retirees will begin to get back in benefits less than they and their employers paid in. The poor will continue to get back more. Social Security provides additional protections—benefits fully protected against inflation, for example—that are available nowhere else. The creation of such a system was a major achievement of the New Deal. It reflected the view that Americans share an obligation to one another, that someone who works a lifetime deserves a pension high enough to support a basic standard of living without the stigma of welfare.

The philosophy of privatization is quite different. It is that each person should make deposits to a personal savings account and enjoy all of the fruits of that saving. Privatization of Social Security would not make the elderly and disabled go away. But it will end a system that requires high earners to help out low earners without forcing low earners to undergo the stigma of welfare. Proposals to privatize Social Security raise important questions that must be answered before these proposals deserve to be taken seriously.

First, will people be free to invest in any sort of asset, as they can through

individual retirement accounts? If so, will administrative costs eat up so much of the return, especially on small accounts, that average returns will be low? What will be done in the case of savers who invest unwisely and reach old age with too little to support themselves in retirement?

Second, if choice among investments is limited, who will regulate the investment choices? Who will assure that the elderly can convert their savings into annuities at a fair price?

Third, how large must the tax increases be to make privatization of any kind work and for how long must these tax increases be maintained?

Fourth, how many elderly and disabled people will have to apply for welfare who are spared the necessity to do so by the internal redistribution of the current Social Security system?

It is quite appropriate for citizens in a democracy to review periodically even a highly successful public program. Such review is imperative when financial problems loom. But the propagation of myths and the creation of an entirely artificial sense of crisis serves neither open-mindedness nor cool deliberation. Both will be needed in large doses in the forthcoming review of Social Security. ♦

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