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IS THE SOCIAL SECURITY SYSTEM REALLY FACING A CRISIS?
Reform is Needed, but the 'Crisis' in the Social Security System is Overblown, Say Levy Institute Scholars

ANNANDALE-ON-HUDSON, N.Y.--Claims that the Social Security System is in crisis and soon to collapse are causing policymakers and others to explore radical financial fixes. But in a new Levy Institute *Public Policy Brief,* ***Does Social Security Need Saving?*** authors Dimitri Papadimitriou and L. Randall Wray contend that the "crisis" has been exaggerated and that none of the current solutions being proposed are desirable or necessary.

In the new paper, Papadimitriou and Wray write that projections of long-range shortfalls have arisen mainly from unduly pessimistic assumptions that the Social Security Trust Fund's trustees have made about the labor force, fertility rates, productivity, wages, and immigration.

"The trustees are assuming that these economic and demographic variables will be far worse than anything experienced in the past," Papadimitriou said. "However, if just a few of the important variables return to long-run trends, particularly labor force growth and the growth of real wages, the gap between income and outgo would be closed without raising payroll taxes or reducing benefits." Even if the trustees' pessimistic assumptions prove correct, their projected financial gap simply does not constitute a "crisis," the authors write.

"On the trustees' intermediate-cost assumptions, outgo will exceed income by just over 2 percent by 2075," Papadimitriou said. "The problem of a shortfall could thus be resolved by increasing the share of GDP to the Old-Age and Survivors' Insurance Fund by about 2 percent beginning after 2030." While a 2 percent increase would not be insignificant, Papadimitriou said, the burden on future workers would not be especially onerous given that real wages over the next half century are projected to increase by about 75 percent. He adds that increases of this size have occurred in the past with little economic disruption.

The more prominent proposals to "save Social Security," such as those advanced by Senator John Breaux and President Clinton, center on accumulating financial reserves over the next few years by some combination of reduced benefits and increased tax rates and by increasing the reserves' growth rate. The president would do the latter by "investing" some of the reserves in the stock market.

According to Papadimitriou and Wray, however, it makes little sense to build up the trust fund now to provide for retirees' future needs. "Unless the accumulation of reserves actually enhances society's ability to produce goods and services in the future, the output to be distributed will be exactly the same whether the Trust Funds are larger or smaller," Papadimitriou said. "The argument for accumulating trust funds rests on shaky theoretical grounds." It is more important to ensure that worker productivity continues to increase so that the workforce can produce the goods and services necessary to provide for all consumers, including the rising number of retirees.

The Social Security system *does* need to be reformed, Papadimitriou and Wray write, but it doesn't need to be radically altered. Instead, the authors offer several policy prescriptions to head off the relatively minor financial problems the system is likely to encounter over the next 75 years:

- The Social Security Trust Funds should be gradually returned to a pay-as-you-go system, with the consequence that payroll tax rates could even be reduced over the next few years.
- Consideration should be given to broadening the base from which Social Security taxes are raised.
- The Trust Funds, which now stand at 200 percent of annual expenditures, should be capped at no more than 100 percent of expenditures, and preferably at 8 or 9 percent of expenditures.
- General fiscal policy should encourage faster economic growth, greater employment, and higher labor force participation.

Most important, they say, major changes, such as partial or complete privatization, reduction of benefits, and extension of retirement age, are not needed. Incremental changes, such as those listed above, will ensure that Social Security remains solvent for many years to come, without the potential upheaval of dramatically revamping the system.

Public Policy Brief No. 55, *Does Social Security Need Saving?*

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