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Retiree Ponzi Scheme Is \$16 Trillion Short: Laurence Kotlikoff

By Laurence Kotlikoff - Aug 24, 2010
Bloomberg Opinion

[Social Security](#) just celebrated its 75th birthday. Love it or hate it, it has done its job and should retire. We need a new system, the Personal Security System, which retains Social Security's best features, scraps the rest, and covers its costs.

Social Security's objective -- forcing people to save for retirement -- is legit. Otherwise millions of us would seek handouts in our old age.

But Social Security has also played a central role in the massive, six-decade Ponzi scheme known as U.S. fiscal policy, which transfers ever-larger sums from the young to the old.

In so doing, Uncle Sam has assured successive young contributors that they would have their turn, in retirement, to get back much more than they put in. But all chain letters end, and the U.S.'s is now collapsing.

The letter's last purchasers -- today's and tomorrow's youngsters -- face enormous increases in taxes and cuts in benefits. This fiscal child abuse, which will turn the American dream into a nightmare, is best summarized by the \$202 trillion fiscal gap discussed in my last column.

The [gap](#) is the present value difference between future federal spending and revenue. Closing this gap via taxes requires doubling every tax we pay, starting now. Such a policy would hurt younger people much more than older ones because wages constitute most of the tax base.

What about cutting defense instead? Sadly, there's no room there. The [defense](#) budget's 5 percent share of gross domestic product is historically low and is projected to decline to 3 percent by 2020. And the \$202 trillion figure already incorporates this huge defense cut.

The 3-Year-Old Vote

Reducing current benefits, most of which go to the elderly, is another option. But such a policy is highly unlikely. The elderly vote and are well-organized, whereas 3-year-olds can neither vote, nor buy Congressmen.

In contrast, cutting future benefits is politically feasible because it hits the young. And that's where Congress is heading, starting with Social Security. The president's fiscal commission will probably recommend raising Social Security's full retirement age to 70 from 67, for those who are now younger than 45. This won't change the ages at which future retirees can start collecting benefits. It will simply cut by one-fifth what they get.

Some political economists point to Social Security's 2010 [Trustees Report](#) and say, "Leave it alone. The system won't run short of cash until 2037."

Misleading Accounting

Unfortunately, the Trustees' cash-flow accounting, like all such accounting, is arbitrary and misleading. In fact, Social Security is broke. Its [fiscal gap](#), which the Trustees measure correctly, is \$16 trillion.

This gap is small compared with the U.S.'s overall \$202 trillion shortfall, not because the Trustees treat Social Security's \$2.5 trillion trust fund as an asset (a questionable choice), but because they credit one-third of federal revenue to the program.

But dollars are dollars. If we re-label Social Security "payroll" taxes as "general revenue wage taxes," Social Security's fiscal gap increases by \$60 trillion, and the fiscal gap of all other government activities falls by \$60 trillion, leaving the overall \$202 trillion gap unchanged.

Even by the Trustees' measure, there's a massive problem. Coming up with \$16 trillion requires permanently raising revenue or cutting benefits by 26 percent, starting now. In other words, the program is 26 percent underfunded.

Hitting Young People

Now cutting benefits of new retirees by 20 percent, with an increase in the so-called full retirement age, starting 20 or so years from now isn't the same as immediately cutting the benefits of all retirees by 26 percent. Hence, the fiscal commissioners will need to hit young people with an even bigger whammy if they really want to solve Social Security's long-term woes.

Most likely, Washington will simply raise the retirement age and kick the can further down the road. This is what the [Greenspan Commission](#) did in 1983, knowing full well that by 2010 the system would be in even worse shape.

I say, retire Social Security and replace it with a version that works. Do this by freezing the current system, paying today's retirees their benefits, while paying workers only what they have accrued so far once they retire.

Next, have all workers contribute 8 percent of their pay to the new system, with half going to a personal account and half to an account of a spouse or legal partner. The federal government would make matching contributions for the poor, the disabled and the unemployed, permitting the system to be as progressive as desired.

Going Global

All contributions would be invested in a global, market-weighted index of stocks, bonds, and real estate. The government would do the investing at very low cost and guarantee that contributors' account balances at retirement would equal at least what was contributed, adjusted for inflation.

Between ages 57 and 67, each worker's balances would gradually be swapped for inflation-indexed annuities sold by the government. Those dying before 67 would bequeath their account balances to their heirs.

While this plan has private accounts, Wall Street plays no role and makes no money. Additional contributions would be used to fund life- and disability-insurance pools.

Our nation is in terribly hot water. Business as usual is no answer. The only way to move ahead is to radically reform our retirement, tax, health-care and financial institutions to achieve much more for a lot less.

The Personal Security System is a major step in that direction. It meets all the legitimate goals of Social Security without the system's waste and penchant for robbing the young.

([Laurence J. Kotlikoff](#) is a professor of economics at Boston University and author of "Jimmy Stewart Is Dead: Ending the World's Ongoing Financial Plague with Limited Purpose Banking." The opinions expressed are his own.)

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