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How Bush Lost Personal Accounts

By Peter Ferrara

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Executive Summary

Synopsis: Bush advanced personal accounts for Social Security during his 2000 campaign, focusing solely on the personal accounts and their benefits for working people, and contrasting them with the alternatives of tax increases and benefit cuts. But once elected, he allowed this reform model to be displaced by tax increases and benefit cuts as the core of reform, with personal accounts as the "dessert." This left the reform without the grassroots appeal to overcome the opposition on such a politically sensitive issue as Social Security.

In his 2000 Presidential campaign, then candidate George Bush brilliantly advanced his proposal for personal accounts for Social Security with positive, even populist, rhetoric. He focused entirely on the personal accounts and all of their enormous advantages, such as higher market returns and benefits, personal ownership and control, freedom of choice, and the creation of family wealth that can be passed on from parents to their children.

The Social Security reform proposal that followed the principles on which President Bush campaigned was introduced in 2005 by Rep. Paul Ryan (R-WI) and Sen. John Sununu (R-NH). That bill would have allowed workers to shift the entire employee share of the Social Security payroll tax to the personal accounts. Over time, the bill would have allowed workers to shift all their Social Security retirement benefits to the personal accounts as well.

From such a proposal, workers would end up with substantially higher benefits from the accounts than Social Security even promises, let alone what it can pay. That results because market investment returns are so much higher than the returns that purely redistributive, non-invested, Social Security can pay.
But the staff appointed to carry out the President's personal account initiative viewed steep benefit cuts, and tax increases if necessary, as the essential focus of reform, with personal accounts as "the dessert". This suited perfectly the opponents of personal accounts, who knew they could use the steep benefit cuts and tax increases to defeat the entire reform.

The centerpiece of President Bush's Social Security reform plan thus shifted to something called price-indexing, rather than personal accounts. Price-indexing would reduce future promised Social Security benefits by close to 40%. It would reduce the effective rate of return promised by Social Security each and every year, eventually forcing everyone well into the negative range. It would reduce the proportion of pre-retirement income replaced by Social Security each and every year as well, until Social Security benefits became relatively insignificant.

By 2005, there was little evidence of the positive themes that the President had so successfully used in arguing for personal accounts during his 2000 campaign. All of that was obscured by Pain Caucus alternatives that were now the focus of the President's plan.

The complete collapse came in the summer of 2005, when President Bush started saying "personal accounts will not solve the problem." The bold breakthrough on personal accounts for Social Security had now collapsed.

It was thus the Pain Caucus model that failed, not the personal account model. It was the Pain Caucus that actually killed Social Security reform and personal accounts, not AARP, or the Left.

Recent extensive polling by Newt Gingrich's new organization American Solutions shows that support for personal accounts for Social Security is still in the mid to high 60s. But achieving such reform will require new leadership.

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How Bush Lost Personal Accounts

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Introduction

In the 2000 Presidential campaign, George Bush's website described his Social Security reform plan as follows:

> But to save Social Security for the next generation, he will lead a bipartisan effort to reform it by giving individuals the option of voluntarily investing a portion of their Social Security payroll taxes in personal retirement accounts. These accounts will earn higher rates of return and generate wealth that can be owned and passed on from parents to their children.[1]

The website further explained,

> Fresh Ideas: Without reform, Social Security benefits will have to be cut by 30 percent or Social Security taxes will have to be increased by 50%. The only alternative is to increase the rate of return workers receive on their payroll taxes. Workers already pay 12.4% of their income into Social Security. The real return people get on this investment is less than 2 percent a year. Over the long term, sound investments in a balanced portfolio of stocks and bonds yield about a 6% return after inflation. Even the safest government bonds yield 4%. Thanks to the magic of compound interest, investing that difference over a lifetime can show dramatic results.[2]

Notice how personal accounts are presented as the alternative to benefit cuts or tax increases. Notice also how personal accounts are presented as a better deal than Social Security, providing higher returns, better benefits, and personal ownership.

The website goes on to mention the following three "Advantages of Governor Bush's Personal Accounts":

- Social Security contributions will earn a higher rate of return, allowing the system to survive without a massive tax hike.
- Personal accounts will allow everyone to build assets and independence.
- If a young worker earning $20,000 a year invested just one-sixth of her payroll taxes in a balanced fund of stocks and bonds, she would likely retire with over $100,000 after inflation. She would own these assets and could use them to supplement her retirement and pass them on to her children.

Similarly, starting on May 15, 2000, the Bush campaign began distributing a Fact Sheet entitled "Governor George W. Bush, Saving Social Security and Medicare." One of the six key principles of reform stated on that Fact Sheet, which was repeated throughout the campaign was:

> Modernization must include individually controlled, voluntary personal retirement accounts, which will augment the Social Security safety net. These accounts will earn higher rates of return, have parameters of safety and soundness, and help workers build wealth that can be passed on to their children.[4]

The Fact Sheet goes on to say:

> Third, instead of dramatically raising taxes and cutting benefits, individual workers could be permitted to establish personal retirement accounts. By allowing younger workers to invest a portion of their payroll taxes in stocks and bonds, these accounts will generate higher rates of return, thus helping to increase retirement income for younger workers.[5]

Again, personal accounts are presented as the alternative to raising taxes or cutting benefits. Indeed, the personal accounts are presented as one of three alternatives for "financing the deficits" of Social Security: raising taxes or cutting benefits, issuing more government debt, or adopting personal accounts.[6]

Finally, the Fact Sheet states:

> Governor Bush agrees with every major bipartisan proposal that modernization must allow workers to invest a portion of their payroll taxes in personal retirement accounts, consistent with parameters of safety and soundness. Because of the impact of compound interest, which Albert Einstein called the most powerful force in the universe, diversified personal retirement accounts can be expected to earn nearly 6 percent after inflation—almost 3 times what Social Security now provides. Many personal account proposals have the added benefit of allowing workers to choose their own retirement age.
>
> Personal retirement accounts would also build wealth, particularly for lower-income Americans. For example, if a 22 year old earning $20,000 a year were permitted, as some bipartisan proposals advocate, to invest two percentage points of her payroll taxes in a personal account involving a mix of stocks and bonds, that account would be worth over $100,000 at retirement….The various reform proposals differ as to the percentage of payroll taxes that may be invested—but all would build significant wealth. These accounts would be owned by workers, used exclusively for retirement benefits, and could be passed from one generation to the next.[7]

Again, personal accounts are presented with purely positive themes, emphasizing that they provide a better deal, higher returns, better benefits, and personal ownership.

On May 15, 2000, candidate George Bush gave a major address on Social Security in Rancho Cucamonga, California. He said:

> Personal accounts build on the promise of Social Security—they strengthen it, making it more valuable for young workers. Senator Moynihan, Democrat, says that personal accounts take the system to its "logical completion." They give people the security of ownership. They allow even low-income workers to build wealth, which they will use for their own retirement and pass on to their children.
>
> Senator Kerrey, also a Democrat, recently said: 'It's very important, especially for those of us who have already accumulated wealth, to write laws to enable other people to accumulate it, and arrive where we are.' Ownership in our society should not be an exclusive club. Independence should not be a gated community. Everyone should be a part-owner in the American Dream.[8]

The future President Bush brilliantly contrasted these positives of personal accounts with the bad alternatives of tax increases and benefit cuts, saying:

> Yet, without reform, younger workers face a great risk—a lifetime of paying taxes for benefits they may never receive. The reforms I have in mind will actually increase their retirement income.[9]

He also said:

> Within the framework of these principles, we can keep Social Security strong and stable. We can keep our commitments. We can avoid tax increases. And millions of Americans will have an asset to call their own. This is the best thing about personal accounts. They are not just a program, they are your property. And no politician can take them away.[10]

Regarding possible payroll tax increases, Bush said:

> Third, the payroll tax must not be raised. We cannot tax our way to reform.[11]

In an extended passage, Bush defended personal accounts in purely positive and populist terms, saying:

> Fourth, reform should include personal retirement accounts for young people—an element of all the major bipartisan plans. The idea works very simply. A young worker can take some portion of his or her payroll tax and put it in a fund that invests in stocks and bonds. We will establish basic standards of safety and soundness, so that investments are only in steady, reliable funds. There will be no fly-by-night speculators or day trading. And money in this account could only be used for retirement, or passed along as an inheritance.
>
> Right now, the real return people get from what they put into social security is a dismal two percent a year. Over the long term, sound investments yield about a six percent return. Investing that four percent difference, over a lifetime, can show dramatic results. A worker who invests even a limited portion of his or her paycheck could, over a career, end up with hundreds of thousands of dollars for retirement.
>
> The American securities markets, over time, have been among the most reliable investments in the world. Through the Great Depression, a World War, and 11 recessions, the overall stock market has never lost money over any 20-year period. It is the best, safest way to build personal wealth. That's why teacher pension plans and private business retirement plans all across America invest in such funds.
>
> Some in Washington call this idea risky. But here are some simple questions you should ask them: Do they own stock themselves? Is that part of their own retirement plan? Does it make them feel more secure, or less, to own investments? Clearly, they don't think this is risky for themselves. People in Washington see it as an opportunity. Yet it is an opportunity they would deny to others.
>
> Every federal worker is offered a personal account to help improve their retirement—1.3 million have these accounts. Al Gore, who calls these bipartisan proposals risky, has a substantial amount of his money invested in the stock market. If he is building his own retirement security in the market, why does he object to young Americans doing the same?[12]

This is exactly how to promote personal accounts and succeed politically.

The Revolution Works

On September 18, 2000, the Cato Institute reported on how candidate Bush was doing with his Social Security personal accounts proposal, saying:

> Social Security has traditionally been a Democratic strong suit but not this year. Whereas polls in the past showed Democrats with a 20-point or more advantage on the question of which party would best handle Social Security, now the parties are running close to even. More important, when voters are asked whether they support Bush's proposal to allow workers to divert a portion of their Social Security taxes to individually owned, privately invested accounts, they strongly endorse the proposal. In the latest Washington Post-ABC News Poll, 59% of voters supported the Bush proposal; 37% were opposed. Vital swing voters are even more supportive of individual accounts. According to a Zogby International poll, 72% of independent voters support individual accounts.[13]

In other words, Bush's positive, populist approach of focusing on the personal accounts alone and emphasizing all of their benefits for the common man was working. Cato also applauded Bush's strategy of contrasting the personal accounts with the unpopular alternatives of cutting benefits and raising taxes, saying:

> It was Bill Clinton who best explained the options available to fix Social Security. There are only three: raise taxes, cut benefits, or increase the rate of return by investing Social Security funds. Clinton proposed to do the latter by allowing the government to invest a portion of the Social Security Trust Fund, a dangerous idea that has wisely not seen the light of day. George Bush proposes to do it by allowing workers to invest for themselves. Al Gore rejects both approaches, opposing any investment of Social Security funds. With investment and higher returns off the table, that leaves Gore with only two alternatives; either he raises taxes or cuts benefits. Bush should simply turn to Gore in debate and ask him which of those he plans to do.[14]

Picking up on the positive, populist theme, Cato also said:

> Social Security is an issue where George Bush can steal Al Gore's populist rhetoric. After all, it is not the rich who need Social Security [personal accounts]. They already have plenty of opportunities to invest, while the poor do not. The result is a growing wealth gap in American society. The richest 1 percent of Americans own nearly half of all the wealth in America. But Social Security [personal accounts] would give all Americans the opportunity to save, invest and accumulate wealth. That is why prominent Democrats such as Sens. Bob Kerrey and Daniel Patrick Moynihan support [personal accounts]. But not Al Gore. On this issue, Gore has clearly sided against working men and women.[15]

Larry Kudlow, who was a senior official in the Reagan Administration, also commented in *National Review Online* regarding the effectiveness of George Bush's campaign for personal accounts in 2000. Kudlow notes in particular the focus on personal accounts and all of their advantages, in contrast to benefit cuts:

> Way back in time, during the early months of the Reagan Administration, a number of the Gipper's more libertarian economic advisers wanted to trash the New Deal—especially Social Security—by severely rolling back benefits in order to shrink government and curb the budget deficit. Wisely, President Reagan always rejected this approach. Time and again, he reminded his staff that he himself voted for FDR four times and went on to vote for Truman. Throughout the budget arguments, Reagan insisted on invoking and preserving the so-called social safety net.

> Yes, he intended to radically transform the economic landscape by slashing marginal tax rates and putting an end to double-digit inflation. And yes, he worked hard to slow domestic spending. But he steadfastly refused to rip large holes through the New Deal/Great Society safety net, believing that these programs were an integral part of the fabric of American life. What's so interesting to me about George W. Bush's freshly minted Social Security reform plan that provides for individual-retirement-account-investing in the stock market—set forth in a speech today in California—is that he makes it clear that he intends to strengthen and save Social Security, not to destroy it. This is smart Reagan-style politics...
>
> What's more, Bush undoubtedly knows that Rasmussen polling data show that 60% of American workers would drop out of Social Security in order to invest privately if they could, and that 80% of American workers now believe that investing their own money will give them more for retirement...
>
> He's almost daring Gore to tell voters how risky and irresponsible this plan will really be, especially since Gore owns stocks and is enrolled in the Federal Thrift Savings Plan that offers personal accounts. More smart politics from Bush.
>
> Stock markets roared approval at the Bush Social Security speech, rallying by 2% despite the continued threat from the Federal Reserve to hike interest rate hikes. The plan is still a bit short on details, but at this point policy vision is more important than number crunching. More than likely, however, the plan will permit 2% of payroll-tax contributions to be invested in a government-approved basket of investment funds. At the same time, Bush will maintain a Social Security benefits safety net, lest the new investments not pay off. He also insists that the payroll tax will not be raised.
>
> Bush asserts that 'American securities markets, over time, have been among the most reliable investments in the world.' Though Al Gore may deny it, this is absolutely true. The historical-empirical research compiled by Roger Ibbotson of Yale and Jeremy Siegel of the University of Pennsylvania shows this to be the case. Going back to 1926 in Ibbotson's research, and 1802 in Siegel's work, the U.S. stock market has thrown off a 7% inflation-adjusted annual rate of return (10% with inflation) through good and bad economic times. Interestingly, their studies also show that stocks outperform Treasury bonds by an average of more than 3 percentage points.
>
> So let's take an average income earner who makes $35,000 a year. His or her 6% Social Security contribution would be roughly $2,100. Two percent per year would therefore be about $700 a year to invest in private markets. Starting at age 25, if this money were invested in a market basket of stocks and bonds returning 8% per year, this would accumulate to nearly $200,000 at retirement age. If the money were invested in large-cap stock funds yielding 11% per year, the cumulative gain would be over $400,000. Not only would this enrich the individual retiree, it would also vastly reduce the required benefit amount payable by the Social Security trust fund. So it's win-win. The investor retires comfortably, while the contingent liabilities of the trust fund are reduced substantially.
>
> The 50% of Americans—and the two-thirds of all voters—who are already invested, know this. But George W. Bush is the first presidential candidate to propose it as policy. Give him credit. Enormous credit. *This is 21st Century breakthrough stuff*. (emphasis added)[16]

These positive, populist themes resonated even into 2005, when Fox News reported:

> President Bush is selling his Social Security reform plan to young Americans, hoping their enthusiasm can help convince lawmakers to push through landmark policy change. But the payoff could also mean more young Republican voters, say political observers...

> But the Bush team and the GOP overall have been savvy about fostering 20- and 30-something voters as their new 'investor class,' as well as mobilizing loyal evangelical youth, [Kathie] Boettrich, [local Democratic Party chairman in Washington, D.C.], said...
>
> But Bush's attempt to change the face of Social Security by offering American workers the chance to invest a percentage of their payroll taxes in private accounts has emphasized the benefits to young voters.
>
> 'We will make the system a better deal for younger workers by allowing them to save some of their payroll taxes in voluntary personal retirement accounts, a nest egg they can call their own, which government can never take away,' the president said in a recent radio address.
>
> 'I think the White House is talking to them directly and I think it's having an effect,' said [Hans] Riemer. director of the Washington, D.C., field office for Rock the Vote, the national youth-oriented voter education campaign. 'I think it's becoming a hot topic on college campuses. That's what happens when the president puts something this big on his agenda—young people respond.'...
>
> Riemer's Rock the Vote is working with AARP, the nation's largest seniors association, in opposition to the Bush plan. But, Riemer acknowledged that he doesn't know whether young workers will back the personal accounts plan...
>
> Boettrich said she was surprised to see 'that Republicans had made some successful connections with young voters' during the presidential campaign. 'There were a number of them who were excited about Bush's Social Security plan.'[17]

In other words, even Democrats and liberals were admitting that the President's personal accounts plan had strong appeal to young voters. But the Fox News report also noted a potential vulnerability:

> Democrats say that once Americans are hip to how the Bush plan works, they won't support it.
>
> 'Once people educate themselves about the real issue of the plan—and we know the plan includes a cut in guaranteed benefits in order to make this privatization scheme happen—younger people are opposed to it,' said Brian Richardson, 25, a spokesman for the Democratic National Committee youth outreach program.
>
> 'We don't want this president cutting our benefits,' he added.[18]

This shows why benefit cuts should never be included in any personal accounts plan. The main argument of opponents against personal accounts is that they require Social Security benefit cuts to work. Adding benefit cuts to personal accounts strolls right into this vulnerability. And, as discussed below, benefit cuts are *unnecessary*, as the personal accounts move the benefits completely out of the Federal budget and into the private sector. So why then would anyone be talking about cutting them?

Fortunately, in the 2000 campaign, Bush avoided this trap and did not include any benefit cuts in his plan. Instead he emphasized that the personal accounts would pay higher benefits, and contrasted the personal accounts with the bad alternatives of benefit cuts or tax increases.

The Dog that Didn't Bark

Perhaps even more shocking than the revolutionary plan from President Bush during the 2000 campaign was what we didn't hear from his opponent in that race, Vice-President Al Gore. You would think that the way Democrats talk about the current Social Security system in such hallowed terms, Gore would have been pounding away at Bush on this issue.

But Gore didn't. Gore did criticize Bush, and there were some ads against the personal accounts, especially late in the campaign. But Gore never came close to developing this attack into a major issue of the campaign. The reason for this is that the Democrats saw in their own internal polls what Bush already knew: Freedom to choose personal accounts for at least part of Social Security is a very popular idea at the grassroots. Polls at the time were consistently showing that 60% to 70% of the public generally supported personal accounts. Moreover, strong majorities of base Democrat constituencies support the idea: African-Americans, Hispanics, and blue collar workers. These constituencies understand personal accounts as a real chance to start accumulating some personal and family wealth.

Freedom to choose personal accounts for at least part of Social Security is a very popular idea at the grassroots.

Attacking Bush over the issue would at best spread the word that Bush was for the popular accounts. At worst, it would place Gore on the wrong side of this issue. Gore, in fact, spent more time on watered down me-tooism than in attacking Bush on personal accounts. Gore proposed an add-on account on top of Social Security, where workers could save and invest additional money on top of what they pay into Social Security. But many voters do not have the discretionary funds for substantial savings on top of Social Security. Moreover, we already have a lot of add-on accounts on top of Social Security, like IRAs and 401(k)s.

The positive themes used by Bush did not just spring out of his campaign. Conservative and free market think tanks had been developing this approach for 20 years before the 2000 Presidential campaign. The pot of gold at the end of this rainbow was what would be the greatest achievement of public policy think tanks in political history, in terms of developing and marketing an idea to real world politicians and policymakers with an enormous impact. Jack Kemp himself remarked a couple of years later regarding personal account reforms, "This is even bigger than Kemp-Roth."[19]

Personal Account Populism Wins

Bush, of course, went on to a narrow victory, with some arguing that personal accounts provided a net gain for him. The proposal did not stop him from winning the senior vote in Florida, and without that he would not have been President.

But Bush was not the only candidate who won on personal accounts. In the late 1990s, Congressional Republican candidates started running on the idea as part of their platforms. They consistently won. The big breakthrough came in 2002, when the Democrats tried to make personal accounts a pivotal issue in the midterm Congressional elections. Top pollster John Zogby summed up the results as follows: "in every campaign where personal accounts were a major issue, the candidate in favor of personal accounts won, and the candidate opposing them lost."[20]

All of these candidates campaigned for personal accounts the way Bush did. They emphasized that the accounts provided a better deal for workers, that benefits for future retirees would go up (not down), that Social Security would be strengthened, and that there would be no tax increases. They did not say they would cut future promised retirement benefits by changing the basic Social Security benefit formula, delaying the retirement age, raising the cap on the maximum taxable income for Social Security, or otherwise increasing payroll taxes.

In 2004, Bush pledged again to adopt personal accounts for Social Security as a top priority for his second term. His opponent John Kerry was even more quiet about it than Gore had been. He, like Gore, talked again at times about add-on accounts. If Kerry's internal polls had shown that Bush was vulnerable over personal accounts, Kerry and the Democrats would have vigorously attacked him over them. But again they did not.

When Bush won decisively in 2004, and Republicans won strong majorities in both houses of Congress, everything seemed poised for fundamental Social Security reform through personal accounts. What Bush should have done at that point was lead with a specific, carefully crafted, personal account proposal that was obviously beneficial to workers and particularly highlighting the benefits to African-Americans, Hispanics, women, families, and, of course, young workers. But he didn't—leaving a vacuum that was filled by a well-designed Congressional plan, but also by less-constructive voices.

How Personal Accounts Work

The Social Security reform proposal that followed the principles on which President Bush campaigned was introduced in 2005 by Rep. Paul Ryan (R-WI) and Sen. John Sununu (R-NH).[21] That bill allowed workers age 55 and under the freedom to choose to contribute to the accounts roughly the employee share of the payroll tax, which is 6.2% of taxable wage income. The bill varied from that because it had a progressive feature that allowed lower income workers to contribute a higher percentage, with higher income workers contributing a somewhat lower percentage. That was adopted to ensure that all workers would enjoy roughly the same percentage net gain in benefits from the accounts.

To the extent that workers exercised this option over their working years, benefits from the personal accounts would substitute for retirement benefits under the old Social Security framework, based on a carefully crafted, proportional formula. If the payroll taxes shifted to the personal accounts over a worker's career were equal to half the worker's Social Security payroll taxes, calculated on a present discounted value basis, the retirement benefits from the personal accounts would substitute for half of the Social Security retirement benefits promised to the worker under current law. If the worker from the start of his career shifted 100% of his Social Security payroll taxes to the accounts, then the account benefits would substitute for 100% of the promised benefits under the current Social Security framework.

Workers currently in the work force exercising the personal accounts would consequently continue to receive a portion of Social Security retirement benefits under the current system based on the past taxes they have already paid into the program. These workers would then also receive in addition the benefits payable through the personal accounts. Workers entering the work force in the future who exercise the personal accounts for their entire career would receive all of their future retirement benefits through the personal accounts rather than Social Security.

Under this formula, workers of all ages up to age 55 would gain from the accounts, with the account benefits greater than the Social Security benefits they replace. But workers would gain more the younger they start exercising the personal account option.

But workers would gain more the younger they start exercising the personal account option.

Workers would choose investments for their personal accounts from a list of investment funds approved and regulated by the Federal government for this purpose. These investment funds would be managed and sponsored by top private investment management firms. The funds would include highly diversified portfolios of stocks and bonds, and other, similar investments. This would be very similar to the hugely successful and highly popular Federal employee Thrift Savings Plan in the U.S., and the similarly successful and popular, now 27 year old precedent in Chile.

This framework would make investment easy for unsophisticated investors. They would not have to pick particular stocks and bonds. They would just pick an investment fund, like a mutual fund, managed by highly experienced, sophisticated, professional, investment fund managers with top expertise, who would be choosing the particular stocks and bonds and other investments, and when to buy and when to sell each of them. Workers would be free to change the investment fund they have chosen each year.

Perhaps most importantly, *the Ryan-Sununu personal accounts retain the full safety net provided by the current Social Security system*. The bill provided a Federal guarantee that all workers who exercised the personal account option would receive at least as much in retirement benefits as promised by Social Security under current law. If the personal account and remaining Social Security benefits for a retiree fell below currently promised Social Security benefits, the Federal government would send the retiree a check each month to make up the difference. This takes the risk issue off the table, and provides a solid foundation for liberals as well as conservatives to support the reform.

The bill provided a Federal guarantee that all workers who exercised the personal account option would receive at least as much in retirement benefits as promised by Social Security under current law.

Moreover, the bill provides for no benefit cuts or tax increases as well for those who decide not to exercise the personal account option. Consequently, this is the only proposal that maintains currently promised benefits as a minimum for everyone. That also should provide a firm foundation for drawing support from liberals as well as conservatives.

In helping to develop an official score for the bill, I personally met for extended periods with the Chief Actuary of Social Security, who provided considerable input regarding how to make the proposal practical and workable. The bill also incorporated the work of G. William Shipman, formerly a Principal at State Street Global Advisors, one of the largest pension fund investment managers in the world. Shipman developed an administrative framework for personal accounts that would make them workable for the investment fund companies as well, and minimize the costs of administration.[22] Under this framework, administrative costs for the bill would be less than 25 basis points, or one fourth of one percent.[23] Just completing and introducing this comprehensive, practical legislation was a huge accomplishment, providing a model for the future.

The Office of the Actuary of the Social Security Administration concluded that virtually all workers would choose to exercise the Ryan-Sununu personal accounts.[24] That is because under the bill all workers would likely gain substantially from the personal accounts, and at a minimum could not lose, because of the guarantee. This means that eventually all Social Security benefits for retirement would be shifted from government spending in the public sector to market investment income in the private sector, resulting in an enormous reduction in government spending equal to about 5% of GDP. The entire Federal government is currently only 20% of GDP. This would be a huge, truly historic achievement.

This is why the official score of the bill by the Office of the Actuary of the Social Security Administration concluded that Ryan-Sununu would achieve full solvency for Social Security.[25] All of the retirement benefits would be taken over by the personal accounts. But half the payroll taxes would still be flowing into Social Security through the employer share of the tax, resulting in an enormous *surplus*. Eventually, remaining payroll taxes could be cut substantially, while still leaving more than enough revenue to pay for all remaining disability and pre-retirement survivors benefits still financed under the old Social Security framework.

Indeed, the portion of the payroll tax paid into the personal accounts would no longer be a tax, because workers would keep the money themselves, and spend it in retirement on their own benefits. They would no longer send the money to the government to be spent on other people's benefits. The remainder of the tax would eventually be cut and, if the accounts were expanded over time to cover survivors and disability benefits, *the Social Security payroll tax could eventually be phased out entirely*.

The result would be the biggest tax cut in world history. Instead of raising Social Security payroll taxes from 12.4% today to close to 20% to pay all promised benefits under the current system, personal accounts would transform the payroll tax from a tax to a wealth producing asset owned by each family.

The current pay-as-you-go system would be replaced with the fully funded savings, investment and insurance of the personal accounts. This would be the largest reduction in government debt in world history.

In the process of this reform, to the extent the personal accounts were eventually expanded to cover all Social Security benefits, the unfunded liability of Social Security would also be completely eliminated. The current pay-as-you-go system would be replaced with the fully funded savings, investment and insurance of the personal accounts. This would be the largest reduction in government debt in world history.

In addition, while the personal accounts would eliminate the long term deficits of Social Security, workers would end up with substantially higher benefits from the accounts. That results because market investment returns are so much higher than the returns that Social Security can even promise, let alone what it can pay. Social Security, in fact, does not make any investments at all. It operates on a purely redistributive, pay-as-you-go basis, with the great majority of the money flowing into the system immediately paid out in current benefits. Even any surplus left over each year is lent to the Federal government and spent entirely on other government programs. This is why Social Security cannot pay good returns over the long run.

An earlier IPI study estimated that because of the much higher market investment returns, the personal accounts under Ryan-Sununu would increase retirement benefits for workers across the board by 80% to 100% for those who exercised the personal account option over their entire careers.[26] At standard, long-term, market investment returns, average income families would reach retirement with over $800,000 in their accounts, in today's dollars, after adjusting for inflation.[27] Even the lowest income workers would be able to reach retirement with $350,000 in their accounts.[28]

After just the first 15 years with the Ryan-Sununu personal accounts, workers would have accumulated in the accounts $7.8 trillion in today's dollars, after adjusting for inflation.[29] This is as large as the entire mutual fund industry today. After just the first 25 years, workers would have accumulated $16 trillion, again in today's dollars.[30]

The new savings and investment flowing through the personal accounts, and the reduced payroll tax burden, would cause an economic boom that would create new jobs and increase the wages of workers at all income levels.

Workers would own this money, personally and directly. They would be free to leave some of it, or all of it, to their children or other heirs. Every worker in the economy would own a share of America's business and industry. The ownership of financial wealth would be far more equal throughout our society. The new savings and investment flowing through the personal accounts, and the reduced payroll tax burden, would cause an economic boom that would create new jobs and increase the wages of workers at all income levels. This would all be nothing less than a revolution in the personal prosperity of working people.

This is the promise of personal accounts. Such reform would be a truly historic breakthrough for market reforms. It should be a top priority for every conservative and free market advocate. It should be embraced by thinking liberals and progressives who are not trapped in the mindset of the 1930s.

But even with personal account reform served up on a platter like this, the Bush Administration lost its way, and failed in confusion . Too many people who should have known better unthinkingly contributed to this failure.

The Pain Caucus

For over three decades now, whenever the Washington establishment has thought about Social Security reform, it was all about cutting benefits and/or raising taxes to deal with the long term financing crisis. In other words, it was all about balancing the Social Security budget. We call these people the Pain Caucus because their reform proposals all involve major pain for the American people.

The budget balancing goal of the Pain Caucus is quite different from the goals of the advocates of personal accounts. The goals of personal accounts are to shift reliance for the functions of Social Security to private capital investment and insurance as much as possible, while providing working people with a better deal. Simply balancing the Social Security budget as it grows to bigger and bigger proportions and imposes an even worse deal on the American people is not solving the problems of Social Security.

Simply balancing the Social Security budget as it grows to bigger and bigger proportions and imposes an even worse deal on the American people is not solving the problems of Social Security.

These relative differences are analogous to those in the broader budget debate. The Pain Caucus always wants a package of tax increases and spending cuts to balance the total budget. But the taxpayer movement wants tax reductions to promote booming economic growth for the American people. These taxpayer advocates and the supply siders argue for balancing the Federal budget by stimulating strong economic growth through tax cuts and restraining the growth of Federal spending to modest levels. This is exactly how the Federal deficits were ended and replaced with huge budget surpluses in the 1990s. The same has been done many times at the state level.

Going back to the 1970s, the Pain Caucus crowd has included Democrats who wanted more tax increases and less benefit cuts, and Republicans who wanted less tax increases and more benefit cuts. By the early 2000s, those Republicans with a pain caucus view tended to follow Bush's leadership and accept the idea of personal accounts. But their concept was basically to just lump the accounts on top of their preferred packages of benefit cuts and tax increases. Some thought the attractive features of personal accounts would be helpful in getting the public to accept the pain of the benefit cuts and tax increases that they still saw as the main event.

The Pain Caucus never really thought through all of the implications of the personal accounts and all of their revolutionary consequences. With the personal accounts shifting benefits out of the public sector and into the private sector, as discussed above, cutting benefits can no longer even be an issue. To the extent the benefits are being paid through the accounts and the private capital markets, the government would no longer be on the hook for the future benefits it would otherwise have paid under the current system. What future benefits would it then cut? Surely it would have no business or even interest in cutting benefits paid through personal savings and investment accounts in the private sector.

Talking about benefit cuts along with personal accounts is like two people on a plane flight from New York to LA who parachute out of the plane over Kansas, and, upon touching ground, start discussing where they are going to have dinner in LA. But once you have opted out of the plane, there is not going to be any dinner in LA that day. And to the extent workers opt out of Social Security and into the personal accounts, ultimately there will be no future benefit obligations under the old system for the government to cut.

Moreover, this process of shifting benefit payments from old Social Security to the new accounts would eventually reduce the benefit obligations of old Social Security so much that it would achieve full and permanent solvency, as also discussed above. With such personal accounts, therefore, Social Security reform advocates need not talk about benefit cuts (or tax increases) at all any more. Instead, they can talk about the better benefits paid through the personal accounts, and even about effective payroll tax cuts. This completely transforms the politics of Social Security from the third rail of American politics to a populist grassroots issue. This is what enabled so many Republicans to start winning elections on fundamental Social Security reform. As Tom Giovanetti has put it, it is personal accounts that turned off the electricity to the third rail of American politics. Even starting with smaller accounts if that is thought to be all that is feasible, the wise political and policy position is to argue for solving all the remaining problems of the system by expanding the accounts over time.

Yet, this was never recognized by the Pain Caucus. As a result, they were hopelessly behind the intellectual curve, and out of touch with the transforming politics of the issue.

The Establishment's Last Stand

The Liberal Washington Establishment had a slightly different take on the issue than the Pain Caucus. They were desperate to force the Social Security reform debate back into the box of tax increases versus benefit cuts. That is because regardless of the amount of any such benefit cuts or tax increases, the basic framework of the old Social Security system would remain in place. Personal accounts, by contrast, would go outside the box, and change the fundamental structure of the program, bringing in a bigger and bigger role for the private sector, and displacing dependence on the public sector.

This was reflected in the Social Security presentation given by AARP Policy Director John Rother. He would argue that the Social Security debate was like a football field. At one end zone was solving the problem with 100% benefit cuts. At the other end zone was solving the problem with 100% tax increases. The only question was where on the field the contending forces would end up. Would they end up at the 50 yard line, with half tax increases and half benefit cuts? Or would they end up on the 40 yard line of the tax increase side, with 60% tax increases and 40% benefit cuts? Or would they end up on the other 40, with the opposite mix? Notice that there are no personal accounts anywhere on this field.

Consequently, the Liberal Establishment would praise any Republican or conservative who talked about benefit cuts or tax increases as being necessary to solve the problems of Social Security. This reinforced the tendencies of even the Republican side of the Pain Caucus, and caused them to work together to try to define anyone who did not accept their tax increase/benefit cut mantra as outside a mainstream consensus. This fooled many personal account advocates into abandoning the politically successful personal account model and wading into the swamp of benefit cuts or tax increases.

Those seduced into this Liberal Establishment game would then find that the uncompromising Liberal position was that gaining their agreement to any benefit cuts would require agreeing to include tax increases as well. It would also require excluding any real personal accounts that would substitute for part of the current system. After publicly agreeing to put tax increases and benefit cuts "on the table", personal account advocates could then no longer turn to grassroots support for their cause. They were stuck with trying to negotiate an Inside the Beltway deal with the liberals, who were adamantly against any real personal accounts.

But besides the Ryan-Sununu bill, the Chief Actuary of Social Security had scored at least four other reform proposals involving personal accounts without any tax increases or Social Security benefit cuts as achieving full solvency.

The only successful political strategy for winning the personal accounts is to go back to the reform model that won so many elections. With a specific reform plan on the table that obviously and overwhelmingly benefits working people across the board, personal account advocates could then take their case to the American people, over the heads of the Liberal Washington Establishment. This is how President Reagan won on issue after issue, including his 1981 tax cuts and budget reductions. This is how Congressional Republicans enacted provisions of the Contract with America, including tax cuts and budget restraint, the fundamental reform of the old Aid to Families with Dependent Children (AFDC) welfare program, and the sweeping Freedom to Farm bill that vastly cut back on outdated Federal farm aid. With a highly appealing, popular, personal account reform plan, President Bush would have been able to win enough grassroots political support to gain enough Democrat votes to pass the proposal.

But the Liberal Washington Establishment teamed up with the Pain Caucus to label any such personal account plan a "Free Lunch". By this they meant that such a plan promises full solvency for Social Security with no tax increases or benefit cuts. But besides the Ryan-Sununu bill, the Chief Actuary of Social Security had scored at least *four other reform proposals involving personal accounts without any tax increases or Social Security benefit cuts as achieving full solvency*. This is achieved by the process described above of shifting so much of Social Security's benefit obligations to the personal accounts that all of Social Security's deficits are eliminated. So those making this charge were again behind the intellectual curve.

Moreover, these critics need to look at what Nobel Prize winner Milton Friedman had to say about financing the transition to personal accounts. Milton Friedman, Speaking the Truth About Social Security Reform, *Briefing Paper No. 46*, Cato Institute, Washington, DC, April 12, 1999. Friedman argued that the entire transition should be financed by issuing debt, as that would just involve explicitly recognizing the implicit debt that already exists in the unfunded liability of Social Security.

But the Ryan-Sununu bill and its "Free Lunch" advocates did not embrace that approach. They sought to pay off the entire transition without any permanent debt. They would finance it by reducing the growth of other government spending and by spending on the transition the increased revenues that would result from increased economic growth due to the reform. That is not a "free lunch". Indeed, some critics of the bill have schizophrenically argued both that it is a free lunch and that the sacrifices it calls for in terms of reduced Federal spending growth and the commitment of the new Federal revenues are too great.

What this Ryan-Sununu transition financing strategy does is allow personal account reform advocates to avoid associating the reform with Social Security benefit cuts, the one area of Federal spending that enjoys the greatest public support by far. Instead it focuses on cutting other general Federal spending, which broad sections of the public support.

For many of us, in fact, the spending restraint necessary to finance the transition would be yet another benefit of the reform. Both the Heritage Foundation and the Cato Institute have published detailed lists of recommended Federal spending reductions that are far greater than the spending restraint that would be necessary to finance the Ryan-Sununu transition.[31] This is the best approach to financing the transition, both economically and politically.[32]

For many of us, in fact, the spending restraint necessary to finance the transition would be yet another benefit of the reform.

But the bottom line on the transition issue is simply this: If financing the transition to Ryan-Sununu accounts equal to the full employee share of the payroll tax is thought to be too big to handle all at once, start with whatever size accounts can be handled. Maybe we start with 3.2%, or even 2%. The transition would be financed from other government spending and economic growth. That will begin to solve the problems.

The full solution would then not be including price indexing or other benefit cuts or tax increases. The full solution would be later expanding the personal accounts to the full Ryan-Sununu level. That would keep the entire reform effort focused on the positive and successful politics of the 2000 campaign. Personal account advocates could then continue to appeal to core constituencies such as African-Americans, Hispanics, and blue collar workers, all of which would especially strongly support a purely positive, well-designed, personal accounts plan.

The Chairman of the Board of the Pain Caucus

From the beginning of the Administration, the chief policy advisor to President Bush for personal accounts was Charles Blahous, Special Assistant to the President for Domestic Policy. Blahous is a highly intelligent man with a Ph.D. in chemistry, an unblemished record of integrity and high mindedness, and a total devotion to the public good.

He came to support personal accounts, but he favored lumping them on top of his benefit cut/tax increase agenda.

Blahous developed a career as a Congressional staffer with an expertise in Social Security. But in that capacity, he was a card carrying member of the Pain Caucus. He wanted to balance the Social Security budget by cutting future promised benefits. But he was enough of a realist to recognize that this approach would require tax increases as well. He came to support personal accounts, but he favored lumping them on top of his benefit cut/tax increase agenda. Indeed, he was probably the lead advocate of the view that the strong public appeal of personal accounts could be used as the carrot to get the public to accept along with them the stick of benefit cuts and tax increases that he saw as doing the real work of achieving permanent solvency for Social Security.

Blahous was the point man for organizing and leading President Bush's Social Security Commission during the first term. He successfully led them to rubber stamp his previously published policy views calling for big cuts in future promised benefits and small personal accounts. Fortunately, Karl Rove wisely required the Commission to propose at least three different reform alternatives, one of which had to be personal accounts alone. Blahous's version of this option, however, was not scored as achieving full solvency for Social Security. In this, Blahous's plan failed where plans by Paul Ryan, John Sununu, Clay Shaw, Bill Archer, Jim DeMint, and myself succeeded. Nevertheless, Blahous used this failure to argue to the President that this proved that personal accounts without benefit cuts or tax increases would not work.

By January, 2005, there was little evidence of the positive themes and rhetoric that the President had so successfully used in arguing for personal accounts during his 2000 campaign. Gone was the discussion of a better deal and better benefits from personal accounts. We barely heard anything any more about ownership, building personal wealth, and leaving an inheritance to children and family.

The focus of discussion had moved to a huge cut in future promised Social Security benefits under the label of "price-indexing."

Instead, the focus of discussion had moved to a huge cut in future promised Social Security benefits under the label of "price-indexing", which we will discuss further below. As for tax increases, while the President proclaimed during the campaign that no tax increases was one of his 7 principles of reform, and that we could not "tax our way to reform", tax increases were now "on the table".

Indeed, the mantra came to be that "everything was on the table", every bad, unpopular idea, such as delaying the retirement age, or means testing, along with the one politically successful idea of personal accounts. These unpopular ideas buried all of the positives of personal accounts, and at best confused the public, as I warned at the time in various publications. Were benefits going to rise under personal accounts, or fall under price indexing? The public soon was lost.

The Wall Street Journal news bureau explained what happened in an interview with Blahous in 2005. "He also helped persuade the president to reject the arguments of some conservatives who say that creating private accounts alone can fix Social Security without more painful changes in benefits and taxes." the *Journal* reported.[33] The *Journal* continued:

> By the time Mr. Bush returned to Social Security last year, Mr. Blahous's side had won a crucial internal battle. Years ago, past advisers say, Mr. Bush leaned toward the "free lunch"

> view—that personal accounts were the answer to Social Security's looming woes, with hard choices on benefits and taxes unnecessary. Mr. Blahous helped persuade the president that there is no free lunch, because even with private accounts, future benefit cuts and perhaps tax increases are needed.[34]

Indeed, the President was now parroting Blahous's pain caucus views, with the Journal reporting, "That approach is reflected in the president's current view, which holds that personal accounts are "the dessert" to make palatable the "spinach" of benefit reductions."[35] Blahous also shortcircuited White House criticism of those calling for tax increases, because he always expected that a final deal with the Democrats would have to include tax increases. That is why tax increases were suddenly "on the table."

In other words, Blahous worked long and hard to turn the President and the Administration away from the approach that had proven so successful in transforming Social Security from the third rail of American politics to a populist issue on which Republicans were winning elections. Instead, the issue was now all about benefit cuts and tax increases, with personal accounts "the dessert". Blahous's strategy, however, was a formula for complete political defeat, which is what happened.

Social Security is perhaps the most sensitive issue in American politics. Any notion of allowing people to opt out of the established system into something like personal accounts was always considered a lost cause. So developing a strategy for personal accounts and Social Security that actually worked in real world campaigns was an enormous accomplishment. Following up with development of fully comprehensive legislation that embodies that approach and is scored by the Chief Actuary of Social Security as achieving full solvency was an historic achievement.

The complete intellectual collapse of the White House effort came in the summer of 2005. In barnstorming around the country supposedly to promote personal accounts and Social Security reform, President Bush started saying "personal accounts will not solve the problem." But he apparently still wanted people to support them anyway, for some unclear reason. "I know personal accounts will not solve the problem," President Bush would say. To which the obvious response is, if they are not going to solve the problem, why are you still talking about them? Contrast this Blahous language with the vision on which Bush won, quoted at the start of this study.

Imagine President Reagan preparing to give a speech on his Star Wars missile defense program being fed by his staff a talking point which read "I know this missile defense system will not work. But I am here today to ask for your support for it anyway."

No wonder the more Bush talked about Social Security reform and personal accounts the more his support dropped on the issue. By the time the President was done trying to promote personal accounts in late 2005, the polls still showed 50% to 60% of the public supporting a personal account option for Social Security, down only about 10 points. But when asked if they supported "the President's plan" on Social Security, support dropped by half, to 25% to 30%. This was the result of the work by Blahous in switching the Administration's concept of reform from the model focusing entirely on personal accounts that the President originally supported, to the Pain Caucus model focusing on a package of benefit cuts and tax increases, with personal accounts as the dessert.

The promising Bush breakthrough on personal accounts for Social Security had now collapsed. Sending the President out to campaign for personal accounts by proclaiming they will not work to solve the problem was one of the more ridiculous episodes of the Bush administration. President Bush was now asking the Republican Party to support, through price-indexing, an enormous cut in future promised Social Security benefits.

As previously mentioned, the Chief Actuary of Social Security had scored several bills involving only personal accounts as achieving full solvency. Besides Ryan-Sununu, there was also a proposal developed by Rep. Clay Shaw, Chairman of the Social Security Subcommittee of the House Ways and Means Committee, which was later co-sponsored by then Ways and Means Committee Chairman Bill Archer.

Shaw and Archer, of course, were serious Washington veterans. Former Sen. Phil Gramm (R-TX) and Sen. Jim DeMint (R-SC), two of the smartest people ever to serve in the Senate, developed other proposals. But George Bush never found out about any of this from Blahous, who did not seem to understand the approach taken by these proposals.

These bills again operated by shifting so much of Social Security's benefit obligations to the personal accounts over time, while leaving enough revenues still flowing into Social Security so that this process would eventually leave huge and permanent surpluses in the system. Understanding this was the key to transforming Social Security reform and particularly personal accounts into politically tenable proposals. For then reformers could stop talking about benefit cuts and tax increases, and instead talk about a better deal for workers and better benefits, accumulation of personal and family wealth, personal ownership, freedom of choice, inheritability of accumulated wealth, and all of the other appealing features of personal accounts. They could talk about the benefits of personal accounts for African-Americans, Hispanics, women, working people, and the poor. This is exactly what the Bush campaign understood and did so well in the 2000 campaign. But this insight was lost in the handoff of the Social Security issue to Chuck Blahous after the election.

Indeed, as noted at the outset, opponents assail personal accounts by claiming that they require large cuts in Social Security benefits in order to fund the accounts. By convincing the President that personal accounts would not work without large benefit cuts, Blahous led the Administration right into this buzz saw, effectively arguing that these opponents of personal accounts were actually right all along.

The problem here was shown especially well in a Heritage Foundation publication, "Would Social Security Reform Lead to a 40% Cut in Benefits?"[36] The publication quoted leading Democrats and advertising campaigns by organizations such as Move On.org alleging that the Bush personal accounts would require a 40% cut in guaranteed Social Security benefits. Heritage gamely attempted to rebut this argument; however, their counterarguments would have been more effective if the Bush plan had not, in fact, included a 40% cut in promised Social Security benefits through the price indexing proposal, as explained below.

Blahous's thinking was taking us back to a reprise of the Greenspan Commission, and to John Rother's football game, ending in some combination of tax increases and benefit cuts, without personal accounts. If this is where we were going, then there was nothing original to cause the President and Republicans to bring up the issue of Social Security reform now. For both economic and political reasons, the Republicans did not need to be birthing a new major tax increase as part of another Greenspan Commission-type overall compromise deal. Yet this is where Blahous was now leading the President, and potentially the whole Republican Party.

The Disaster of Price-Indexing

With Blahous inducing the President to barnstorm around the country effectively denouncing his own personal accounts idea, by the summer of 2005 the centerpiece of Bush's Social Security reform effort became something called "price indexing" rather than personal accounts. This reflected Blahous's thinking, because price-indexing was really the centerpiece of his concept of Social Security reform.

Here is what price-indexing is really all about. Under the basic benefit formula of the current Social Security system, during a taxpayer's working years the future benefits that are to be paid to the worker increase each year at the rate of growth of wages. (This is different from the Cost of Living Adjustment [COLA], which increases benefits *after* retirement by the rate of inflation, or CPI).

Price indexing would change this basic benefit formula and the calculation of future Social Security benefits so that while a taxpayer is working, the future benefits to be paid to the worker would increase only at the rate of growth of *prices*. Wages regularly grow faster than prices, about 1% faster per year faster, reflecting the growth in real wages over time.

This change would *freeze Social Security benefits* at today's levels in real terms, after inflation, a hard proposition to advance politically. Such price indexing would be a massive cut in the Social Security benefits that would be paid in the future under current law, so massive that it would be enough by itself to eliminate the long term Social Security deficit entirely. *For today's young workers, future Social Security benefits promised under current law would be cut by close to 40%* from the levels that would otherwise be paid. As time goes on, and benefits continue to grow more slowly than wages, this cut from currently promised benefit levels would become even larger, eventually reaching 50%, and continuing on even higher.

Some argue that this is just fine. Since wages grow about 1% more than prices each year, current law linking benefits to wage growth produces an unjustified increase in real benefits over time, they contend. With huge future deficits in the program, such an increase would be irresponsible and unfair to future workers who must pay the taxes to support such benefits, they say.

Yet with the payroll tax, *taxes also grow at the rate of growth of wages over time*. Is it unjustified or unfair to expect benefits to at least grow at the rate of growth of wages as well?

Even with the benefits growing along with wages as under current law, the rate of return Social Security would pay would still be meager. *It is the wage indexed benefits of the current system that advocates of personal accounts have long criticized as providing below market returns*. Even with the current wage indexed benefits, Social Security's rate of return for most workers today would be 1 to 1.5% or less. For many it would be zero or even negative.[37]

Under price indexing, with taxes growing at the rate of growth of wages and benefits growing only at the rate of growth of prices, the rate of return promised by Social Security would decline each and every year in *perpetuity*! Returns for all workers would eventually be forced down into the negative range, and then eventually deeper into that range, over time. This is what would be unfair to future workers. Consequently, price indexing is not a solution to the current system's problems. It only makes those problems worse, by making the program even more of a bad deal than it already is.

Under price indexing, with taxes growing at the rate of growth of wages and benefits growing only at the rate of growth of prices, the rate of return promised by Social Security would decline each and every year in perpetuity!

In addition, worker's incomes naturally increase at the rate of growth of wages over time. Under the current wage indexed Social Security system, with benefits increasing with wages as well, the Social Security replacement rate, or the percent of pre-retirement income replaced by Social Security, remains the same over time. What this means is that in the future, Social Security benefits will seem to be at the same level relative to everyone else as today. Currently, Social Security replaces close to 40% of pre-retirement income for average income workers, and 28% for higher income workers, and under the current wage–indexed system that would continue into the future.

But under price-indexing, with benefits only growing with prices, while incomes grow with wages, the Social Security replacement rate would decline each and every year again in *perpetuity*! The replacement rate would decline to 30%, then 25%, then 20% by the time today's young workers retire. It would then continue to decline, to 10%, to 5%, over time, asymptotically approaching zero.

This is why at a conference in Washington during the height of the Social Security reform battle, one fervent price indexing advocate was asked by the moderator, "Isn't it true that under price indexing Social Security benefits are eventually reduced to insignificance?" The advocate, being both intelligent and honest, gave an accurate one word answer, "Yes."

Of course, all of this shows that *price indexing will ultimately be politically indefensible*. When Democrats make the above claims against Republicans who supported price indexing, the Republicans will not be able

Combining the huge cuts of price indexing with personal accounts allows the Left to say simply, "See, we told you so."

to say their accusers are wrong. Reducing Social Security benefits to insignificance is not a good theme for reformers. What may seem reasonable to Inside-the-Beltway Washington analysts today can seem ridiculous on the campaign trail later. Indeed, price indexing is the perfect foil for the Left's false charge that personal accounts require large cuts in Social Security benefits. Combining the huge cuts of price indexing with personal accounts allows the Left to say simply, "See, we told you so."

Essentially, price indexing approaches the Social Security financing problem like this: If nothing is done to reform Social Security, by the time today's young workers retire, there will only be enough money to pay 60% to 70% of currently promised benefits. Price indexing "solves" this problem by changing the Social Security benefit formula so that by the time today's young workers retire they will only get 60% to 70% of currently promised benefits. This is not a solution. *This is the problem we are supposed to be trying to solve!*

How can reformers expect the grassroots to rally for a reform centered around this price-indexing notion? How inspired will they be if reformers tell them we are going to save Social Security for you by cutting your future promised benefits by 40% and delivering to all of you a negative real rate of return on the several thousand dollars each year we are going to force you to continue to pay into Social Security?

Ultimately, with personal accounts, price indexing in any form no longer makes any sense. As the accounts shift the payment of benefits from the public sector to the private capital markets, where workers will actually get higher benefits than promised by Social Security, there is no point in then trying to cut the benefits that would have otherwise been paid in the public sector. Once the personal accounts shift the retirement benefits to be paid through the private sector, there would no longer be any benefits paid in the public sector for price indexing to cut!

In other words, *the personal accounts already phase out the current wage-indexed Social Security benefits, replacing them with better benefits earned through market investments*. Doesn't it make sense to address the over-promises of the wage indexed benefits within the current system in this way, rather than trying to cut those benefits? Price-indexing is not a new idea. It arose in the 1970s when the country first considered indexing Social Security to operate in a steady state into the future. But then President Gerald Ford, along with the Congress in overwhelming bipartisan agreement, rejected it for the above reasons.

Yet those among the Pain Caucus who had fought for price-indexing back then could not let it go when personal accounts came along. Price-indexing was now the centerpiece of reform. Personal accounts were the dessert. And so we had the same result as in the 1970s – complete failure.

But not before some more befuddled direction from Blahous and crew. They had run around Washington spreading the inside word that Democrats were willing to support personal accounts if only the Republicans would embrace price-indexing. They called conservative leaders across the country to divulge this "inside scoop."

But to this day, not one elected Democrat has risen to endorse personal accounts in return. *Indeed, not one elected Democrat has risen to endorse price-indexing in any form.*

Those Washington insiders who hijacked the personal accounts political movement for their losing idea of price indexing are the ones who actually killed Social Security reform and personal accounts, not its opponents.

New Twist, More Problems

In recognition of the validity of the above criticisms, the policy discussion began shifting in late 2005 to what is called “progressive price indexing.” Under this proposal, the current wage indexing system would continue to apply to workers making less than $25,000 per year. The full price indexing system described above would apply to all workers making over $113,000 per year. For workers between $25,000 and $113,000 per year, a mix of wage indexing and price indexing would apply, with more price indexing and less wage indexing as income rose.

But all of the above criticisms would continue to apply for everyone making over $25,000 per year. The impacts would just be phased in more slowly for workers earning between $25,000 and $113,000 per year. Their benefits would still be growing more slowly than their taxes, reducing the rate of return each and every year. This effect would just occur more slowly the lower their income is. Their benefits would also still be growing more slowly than their incomes, reducing the replacement rate each and every year. This effect would again just occur more slowly the lower their income is. The same long term cut in the current promised level of benefits would still eventually be reached.

The Left, as represented by the Center on Budget and Policy Priorities, responded to the progressive price indexing idea by publishing the table below, which shows how sharply future promised benefits would be cut from currently promised levels.

Table 1 **Future Benefit Cuts From Progressive Pricing**

	2025	2045	2075
Low Income ($16,428 in 2005)	0%	0%	0%
Average Income ($36,507 in 2005)	-6%	-16%	-28%
High Income ($58,411 in 2005)	-10%	-25%	-42%
Maximum ($90,000 or more in 2005)	-11%	-29%	-49%

Source: Social Security Administration; Center on Budget and Policy Priorities.

There is no sound rebuttal to this data.

Moreover, the proposal creates a new problem. Because the reduction in future promised benefits is greater the higher income goes, *the proposal effectively imposes a tax on rising incomes*, discouraging work, productivity and entrepreneurship. This would reduce economic growth.

The Pied Piper of Tax Increases

Once the Administration and other reformers embraced progressive price-indexing, then there was another problem. Any time we try to cut future promised benefits, liberals will respond by insisting that we can’t close the long term Social Security financing gaps only by dealing with the benefit side. They will insist that the package has to involve at least half tax increases to go with the benefit changes. Remember John Rother’s football game. *So supporting price indexing in any form inevitably leads to tax increases as well on these grounds*.

Moreover, once we are in the swamp of benefit cuts and tax increases, the personal accounts will become a bargaining chip that Republicans would give up in the end to get Democrat cover for the benefit cuts. The Democrats have insisted that they will never support real personal accounts that substitute for part of the current Social Security system. They have said they will support only “add on accounts” that operate with contributions and benefits outside of and on top of the current system.

Add-on accounts do nothing to eliminate the long term deficits of Social Security.

Such add on accounts, however, do nothing to solve the problems of Social Security. Workers would still be suffering the bad deal and low returns and benefits the current Social Security system offers them, made all the worse if taxes are also raised and future benefits cut. Moreover, add-on accounts do nothing to eliminate the long term deficits of Social Security, as real accounts would do as described above. Finally, only real accounts offer an historic opportunity for massive reductions in taxes and government spending, all while making workers better off. The add-on accounts, however, have no such effects, and so fumble away this historic opportunity.

We already have plenty of add-on account options in the form of IRAs, 401(k)s, etc. Low and moderate income workers do not have the spare cash to contribute significantly to them. Some have proposed that the government match contributions to such accounts, or even make the contributions for the worker. But this would create a new entitlement program on top of Social Security, instead of addressing the massive problems of the enormous Social Security entitlement program we already have. Indeed, we cannot afford the overwhelming entitlement promises we have already made. How can we just keep adding new entitlement programs on top of them?

I had argued at the start of 2005 that this is where we would end up if we turned Social Security reform into the old game of negotiating a package of tax increases and benefit cuts.[38] The liberals were not going to budge on their opposition to real personal accounts. If there was going to be a negotiated deal with them, then it was not going to include such personal accounts. That and a proportional tax increase was going to be the price of getting them to agree to the benefit cuts.

The only way to get out of this was, again, to go over their heads and take the case directly to the American people. But that is not going to work with a package of benefit cuts and tax increases, and personal accounts as the dessert.

We saw over and over again during the Social Security reform debate exactly this process of personal account advocates stumbling down the road first to benefit cuts, then to tax increases, and then to abandoning the personal accounts. Sen. Lindsey Graham started out as an advocate of personal accounts who was going to get the job done. He was told, just as so many others were, that the Democrats would agree to personal accounts if only he would support price indexing.

So Graham publicly announced early in 2005 that he was now for price-indexing along with personal accounts. But then he started hearing from real Democrats as to what they wanted. So a few weeks later Graham publicly announced that now he was for personal accounts, plus price indexing, plus tax increases.

But Graham soon learned that even that wasn't enough. So a few weeks later he publicly announced that he had discovered that personal accounts were a "sideshow." The real action in solving the problems of Social Security was in the right mix of benefit cuts and tax increases. The Liberal Washington Establishment had taken him to school.

Many of the original sincere advocates of personal accounts went through the same process. A prime example was For Our Grandchildren (FOG), headed by Lea Abdnor. FOG was founded to advance the cause of personal accounts

But part of the Social Security reform follies surrounding Bush's badly confused campaign for personal accounts is that this organization, which could have been so timely and helpful, ended up supporting everything but large personal accounts.

Abdnor bought into Blahous's, price-indexing concept , and promoted a pledge among candidates in the 2006 elections that "everything would be on the table" in negotiations for a Social Security deal after the election.[39] "Everything on the table" was the code for a willingness to agree to tax increases as part of the final deal.

Abdnor and her group thought "everything on the table" meant personal accounts too. But the Democrats quickly made clear that while "everything on the table" did mean tax increases, it did not mean real personal accounts as well, for they refused to even consider such accounts in any negotiations. As far as they were concerned, personal accounts were not on the table in any negotiations with them.

That end result should have been obvious from the beginning. So Abdnor and FOG poured resources into an effort that fought to put tax increases on the table, which created an opening for a possible Social Security deal for the President, but left the personal accounts the organization was supposed to be supporting on the cutting room floor.

Even after this, some of the libertarians originally supporting personal accounts were induced by Blahous into arguing openly for tax increases, in return for some benefit cuts, even without the personal accounts.[40] These folks had consequently followed the same path as Lindsey Graham, from personal accounts to price indexing to tax increases to no personal accounts. In other words, in trying to fight for personal accounts, they had been chewed up and spit out by the Liberal Washington Establishment, turned around into supporting tax increases instead.

The same pattern can be seen in the journey of Wall Street financier Robert Pozen. In 2005, he authored an article in *The Wall Street Journal* calling for the progressive price indexing the President later endorsed. In early 2007, he authored another article arguing that for price indexing to be accepted by the Democrats, tax increases would be necessary as well, and real personal accounts had to be off the table.

Even the Administration ended up following the same road. They went from personal accounts to progressive price indexing as well to tax increases are on the table to background support for raising the Social Security maximum taxable income. In the end, Blahous was urging his courtiers to call for supporting the tax increase in return for benefit cuts, even without the personal accounts. Robert Novak reported in his column in January, 2006 that the new Treasury Secretary Henry Paulson was discussing just such a deal with the Democrats. Even that failed because the Democrats were still not willing to cut Social Security benefits.

Again, I had predicted precisely this result in numerous publications starting in 2005 and even earlier,[41] reflected in the arguments above. It all turned out exactly as predicted. Blahous and other Administration officials were forewarned years in advance. But Blahous and his allies rejected that advice and continued with their pain caucus model. It was that model that failed, not personal accounts. We tried their way, and it predictably blew up on the launching pad. Personal account reformers need to go back to the populist model of pure personal accounts that worked so well on the campaign trail, and in originally bringing the idea to the national stage.

More Social Security Reform Misleadership

The plague of Social Security reform follies ultimately killing any Social Security reform spread beyond the White House. Chief case in point is Maya McGuineas of the New Century Foundation and the Committee for a Responsible Federal Budget. Her unique contribution to the reform movement is to argue that Social Security benefit cuts should not be limited to future retirees. Even current retirees should "share" in the sacrifice by suffering benefit cuts as well.[42]

As suggested above, the Liberal Washington Establishment loves to feature Ms. McGuineas saying this whenever it can, because it helps to promote benefit cuts and tax increases as the solution. But for the liberals there is an extra bonus here. For the more such talk of cutting benefits for today's retirees is heard, the less likely it is that any Social Security reform will see the light of day in Washington.

Obviously, those who want to achieve actual Social Security reform need to distance themselves from all such talk of cutting benefits for today's retirees. Indeed, combining such talk with any advocacy of personal accounts is the most effective way to kill the idea.

Another case was one organization's President who wrote to his supporters that because the Ryan-Sununu bill did not cut Social Security benefits it actually increased government spending. But, as discussed above, that bill would actually replace all Social Security retirement benefits over time with higher and better benefits from the personal accounts. That would result in the largest reduction in government spending in world history by far, reducing Federal spending by a gargantuan, unprecedented 5% of GDP. Moreover, Ryan-Sununu financed the transition in part by reducing Federal spending over time by another 1.6% of GDP, a free market dream.

A staffer at another organization misled his superiors by ballyhooing the estimated $7 trillion in needed transition financing over 75 years for Ryan-Sununu. That bill planned to finance half the transition by restraining the growth of Federal spending. Federal spending over the next 75 years would be $200 to $250 trillion under the same long term projections used by the Social Security Administration. But the staffer's own organization at the very same time was publishing papers calling for much greater reductions in Federal spending than would have been required by the Ryan-Sununu transition financing plan!

Conclusion

President Bush was courageous and insightful in picking up the idea of personal accounts and advocating them in his 2000 campaign. But as happened in so much of his Administration, the President was let down by those serving him, who directed the campaign for personal accounts into a flaming political disaster. Of course, the President should have had the moxie to recognize that his instincts were correct and to see that he was being misled.

The battle for personal accounts was not lost among the American people out across the country. It was lost in Washington.

The bottom line, however, is that the battle for personal accounts was not lost among the American people out across the country. It was lost in Washington.

Recent polling by Newt Gingrich's organization American Solutions confirms this.[43] After hearing a description of a reform proposal similar to the Ryan-Sununu bill, the public supported the plan by 62% to 30%. By 64% to 31%, the public favored allowing workers the freedom to choose such personal accounts. By 67% to 28%, the public favored such a personal account option with a federal guarantee that the worker's retirement benefits would be at least as high as Social Security would pay them in the future under current law, as included in Ryan-Sununu.

Gingrich's polls also asked, "How important is it for the President and Congress to address the issue of Social Security in the next few years?" A shocking 96% of the American people said it was important, with 86% saying very important. Only 2 percent said it was not important.

Another question asked "Do you agree or disagree that the current Social Security system is broken and if it isn't reformed, future generations will no longer have it as a safety net for retirement?" 80% agreed, including majorities of two thirds or more for every age group. Only 19% disagreed.

Clearly, the opportunity to achieve the promise of personal accounts still exists. But new leadership will be necessary.

Endnotes

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