IPI
Insights
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PUTTING SOCIAL SECURITY IN YOUR HANDS

By Peter Ferrara

A revolution in opinion and policy regarding Social Security is sweeping the world. Countries of varying social philosophies and economic strengths around the globe are converting their traditional retirement programs into personal investment accounts. In this country the concept is emerging as a viable option to "saving Social Security."

Even more revolutionary for American politics is the fact that privatization is getting bipartisan support. In citizen polls, as many Democrats favored a personal account option as did Republicans.

But the Clinton Administration has made no provisions for personal investment accounts in its Social Security reform plan. Instead, the administration is involved in static rhetoric that pits tax cuts against fixing Social Security, as if we can only do one or the other. But, in fact, with the right kind of Social Security reform and the right kind of tax cuts, we can do both. And, in fact, *the right kind of Social Security reform IS a tax cut.*

Both Social Security reform and tax cuts should be top priorities for Congress and the President over the coming year.

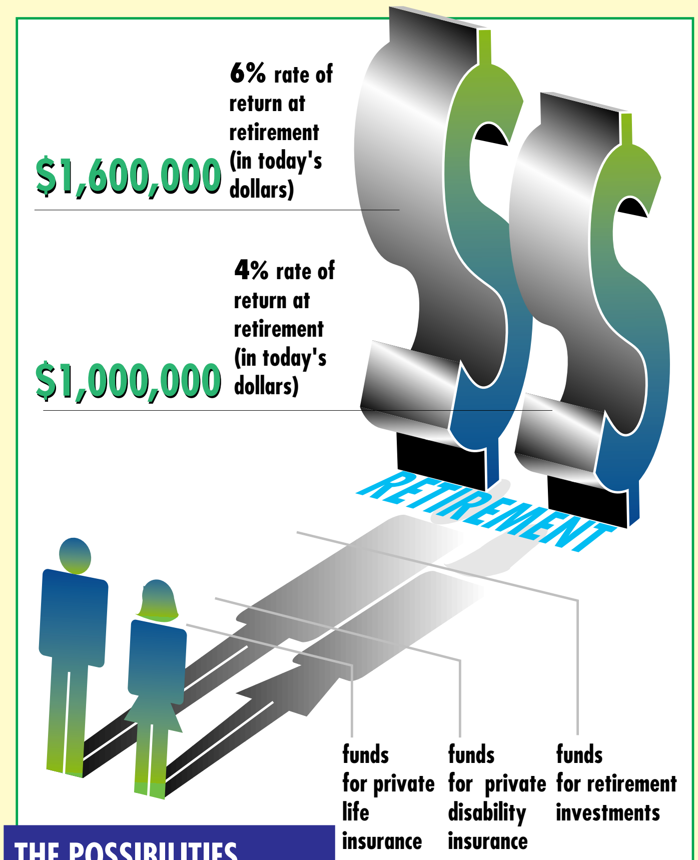
Freedom and Prosperity

Nothing would do as much to increase the liberty and prosperity of the American people as moving a portion of their Social Security contributions into private accounts. If workers shifted into such personal accounts now, the long term Social Security financial crisis would be averted. As a result, we would then avoid an eventual payroll tax increase of 50% to 100% or more, which would otherwise be necessary to pay promised benefits.

But Social Security faces an even bigger problem than its financing crisis. Even if it somehow pays all its promised benefits, it has become a bad deal for working people today, de-

INSIDE:
Spending the Surplus

ALSO:
Burying the Estate Tax



THE POSSIBILITIES

A married couple entering the workforce in 1985 investing Social Security funds in the private sector.

> "This could spur the biggest reduction in government spending in world history"

> "Social Security makes no real investment at all"

priving them of the vastly greater prosperity they would enjoy if they could save and invest their funds throughout the private sector instead.

Take the example of a husband and wife entering the work force in 1985, each earning the average income each year for their entire careers. What would happen if this couple could save and invest in the private sector what they and their employers would otherwise pay into Social Security?

With part of their account funds devoted to private life insurance to match or exceed Social Security retirement survivors benefits, another portion devoted to private disability insurance, and the rest devoted to retirement investments, the couple would retire with almost $1 million in today's dollars, assuming a 4% real rate of return. That's just over half of the average return in the stock market over the last 75 years. At a 6% rate of return, the couple would retire with $1.6 million in today's dollars. In addition to receiving a retirement benefit equal to or greater what Social Security provides today, the couple would have a substantial estate to leave to their children. *(see graph on left)*

These vastly greater benefits would result not because the private sector would make better investments than Social Security. They result *because Social Security makes no real investment at all.* Social Security is a tax and redistribution scheme where almost all taxes paid today are immediately paid out to current beneficiaries on a pay-as-you-go basis. The private, invested system, by contrast, pours its funds into real private capital investment that produces new income and wealth. That increased income and wealth is what finances the far higher returns and benefits of the private system.

Free Market Growth

A full, private account option would also ultimately involve a huge tax cut. Workers and employers would not need to pay as much into the system due to the higher returns of the private investments. Eventually as workers came to rely on their private accounts, the payroll deductions would be phased out altogether, reducing the overall Federal tax burden by about one-fourth. This could spur the biggest reduction in government spending in world history.

Such dramatic reforms to the existing Social Security system would stimulate a dramatic change in the political culture. Consider what politics would be like if retirees, instead of being dependent on government benefits, were independently living off of substantial accumulated private trust funds, invested in stocks and bonds. Then every government threat to the private economy would be a direct threat to the incomes and security of retirees. Anti-market policies that would tank the stock or bond markets would no longer be politically viable. A new political culture of independence through the private economy would flourish.

Tax Cuts

Such Social Security reform is also the key to enacting a general tax cut today outside of Social Security. The Clinton administration is attempting to frame the economic policy debate as a choice between Social Security on the one hand and a general tax cut on the other. The argument is against a tax cut that returns some of the general budget surplus to the taxpayer because as they say, the surplus is needed to "save Social Security."

Tax cutters can avoid this trap by advancing a personal account option for at least part of Social Security now, which will then be phased up to a full option over the years. This plan far exceeds any currently being proposed by the administration.

Conclusion

A stunning and historic opportunity for freedom and prosperity for working people lies waiting for national political leadership. American workers should enjoy the same freedom that workers are now winning around the world to choose to save their Social Security money in their own personal investment and insurance accounts. That would open up a whole new realm of prosperity for working people in America. And it would ultimately produce the greatest reduction in government taxes, spending and debt in world history.

Peter Ferrara is General Counsel and Chief Economist at Americans for Tax Reform and co-author with Michael Tanner of the book A New Deal for Social Security.

Privatizing Social Security is Better for Everyone

For the example used in this article of an average income-earning couple entering the work force in 1985, we devoted part of the account funds to private life insurance to match or exceed Social Security preretirement survivors benefits. Another portion of the funds was devoted to private disability insurance to match or exceed Social Security disability benefits. The rest was devoted to retirement investments.

At a 4% real rate of return on such investments, which is just over half the average return earned in the stock market over the last 75 years, the couple would retire with almost $1 million in today's dollars. That fund would pay them more out of continuing investment returns alone than Social Security promises (but cannot pay), while allowing them to leave the almost $1 million to their children. Or the funds could be used to buy an annuity paying them over 3 times what Social Security promises but cannot pay.

> It's true for all workers today of all income levels

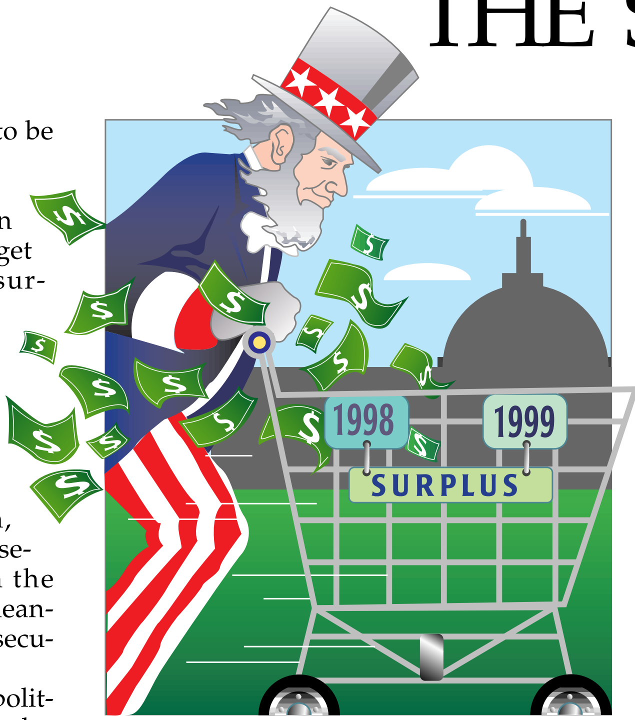
At a 6% real return, the couple would retire with $1.6 million in today's dollars. That fund would pay them about 3 times as much as promised by Social Security, while allowing them to leave the entire $1.6 million to their children. Or it would finance an annuity paying them 7 times what Social Security promises, but cannot pay.

The same is true for all workers today of all income levels, family combinations, and ethnic groups—rich or poor, black or white, married or single, with children or without, one earner couple or two earner couple. Even low income workers who receive special subsidies through Social Security would receive much more in benefits from the personal investment accounts.

Take the example of a low-income couple with 2 children. Husband and wife enter the work force in 1985 and each earn the equivalent of today's minimum wage each year throughout their careers. Through the personal investment account, at a 4% real return, the couple would retire with a fund of $375,400 in today's dollars. The couple could use this fund to buy an annuity that would pay them about 2.5 times (2.44) what Social Security promises but cannot pay. Or the couple could use part of the fund to buy an annuity matching what Social Security promises, while leaving $220,000 to their children.

At a 6% real return, this low income couple would retire with a trust fund of almost $700,000 ($693,395) in today's dollars. That fund would pay them more than twice (2.26 times) what Social Security promises out of the continuing returns alone, while allowing them to leave almost $700,000 to their children. Or they could use the funds to buy an annuity that would pay them about 5 times what Social Security promises, but cannot pay. – *Peter Ferrara*

SPENDING SPREE SHRINKS THE SURPLUS



1998 was supposed to be the year when large U.S. budget surpluses would result in large tax cuts for American taxpayers. In fact, the 1998 budget ended up with a $70 billion surplus. But not only were there no tax cuts, it appears there is little support for significant tax cuts anytime in the foreseeable future. How did this happen?

The answer lies in the strategy by President Clinton, with his pledge to "save social security first," combined with the failure of Congress to couple meaningful tax cuts with true social security reform.

The "Clinton Pledge" was a political gesture pure and simple: by linking budget surpluses and "saving social security" in the public's mind, the President was able to forestall serious efforts to rebate surpluses to the taxpayers.

Although Republican tax cut initiatives surfaced repeatedly throughout the year, they ultimately collapsed in the face of charges that they were "robbing" the social security trust funds. Tax-cutters were put in another bind by the allegation that tax cuts had to be "paid for" with offsetting tax hikes or entitlement cuts even in an era of surpluses.

Congress has already spent nearly half the projected surplus for 1999

Under the circumstances, at least taxpayers could gain some solace in knowing that the surplus was being used to "save" social security and wasn't being squandered on additional federal spending, right?

Wrong! By the end of FY 1998 the President and Congress managed to throw away at least $20 billion of the projected 1999 surplus in an orgy of pork barrel spending. This "urge to splurge" took the form of the Administration's demand for another International Monetary Fund bailout, and Congress' eagerness to dole out scores of new highway, mass transit,and"infrastructure" projects.

Towards the end of the FY 1998, Congress and the Administration dug deeper into the surplus by indulging in a year-end spending spree which included funding a wide range of "emergency" items that should have been handled within agreed-on spending caps. While much of this spending represents a positive shift in priorities — such as strengthening embassy security — characterizing them as "emergency" allowed Congress to spend this money without having to set priorities relative to other, less important programs.

Preliminary estimates on how much of the projected surplus was spent during the 1998 congressional session are in the range of $34 billion: funds that could have been used for tax reduction, debt retirement, or "saving social security" (however that goal is defined).

And with Congress and the President conspiring to spend a third or more of the 1999 budget surplus, it virtually obligates the government to spend the same amount or more of future surpluses. Hence we have a situation where taxes are at a record peacetime high as a percent of national income, budget surpluses are projected as far as the eye can see, and yet the political will to cut taxes collapsed in the face of "save social security first" rhetoric.

So what should be done about it? First, *Congress should stick firmly to budget procedures and guidelines*, and work with committee chairmen to finalize spending and tax decisions as early as possible in the budget year.

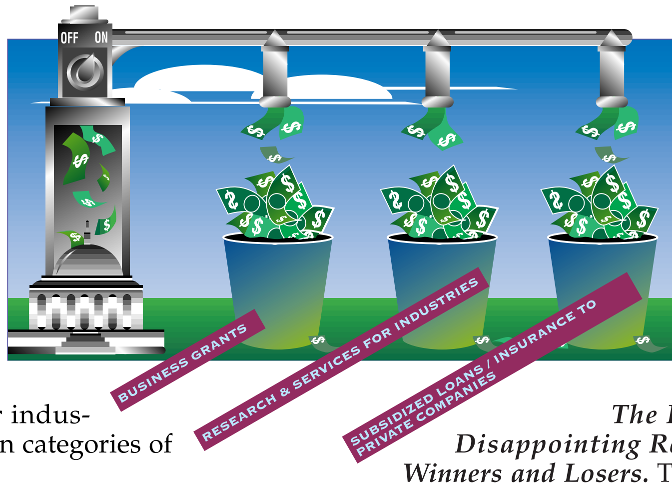
Second, *Congress should take surpluses out of the usual budget deliberations*, thereby improving the odds that Congress will stick to spending priorities established within an overall spending total.

And third, *Congress should give it back*. A commitment to give the surplus back to the taxpayers can create a decisive political constituency for both tax and spending restraint. As such, it represents the most potent strategy for preventing the political establishment from squandering the surplus and growing government even more. IPI

This article was taken from a recent IPI issue brief entitled "Honey, I Shrunk the Surplus" *by Lawrence Hunter, George Pieler, and James Carter. Copies are available upon request, and are also available on our website at www.ipi.org.*

Ending Corporate Welfare As We Know It

BY DEAN STANSEL



While everyone seems to be opposed to corporate welfare, not everyone defines it in the same way. "Corporate welfare" should be carefully defined as any government *spending* program that provides unique benefits or advantages to specific companies or industries. There are three main categories of corporate welfare:

Direct Grants to Businesses. Perhaps the most egregious example of corporate welfare is the Agriculture Department's $90 million a year Market Access Program, which gives taxpayer dollars to exporters of food and other agricultural products to offset the costs of their overseas advertising campaigns.

Programs That Provide Research and Other Services for Industries. The Energy Department's Energy Supply Research and Development program ($1.9 billion a year) aims to develop new energy technologies and improve on existing technologies with demonstration ventures and applied R&D projects in partnership with private-sector firms.

Programs That Provide Subsidized Loans or Insurance to Private Companies. The Export-Import Bank ($700 million a year) uses taxpayer dollars to provide subsidized financing to foreign purchasers of U.S. goods through the use of direct loans at below-market interest rates, loan guarantees to private lenders, and subsidized export credit insurance.

Corporate welfare programs are often touted as pro-business. They are not. Such programs do nothing to promote a freer economy. They make it less free. Here are seven reasons why such policies are misguided and harmful:

The Federal Government Has a Disappointing Record of Picking Industrial Winners and Losers. The average delinquency rate for government loan programs is almost three times higher than for commercial lenders.

Corporate Welfare Is a Huge Drain on Taxpayers. Every year $65 billion is spent on programs that subsidize businesses, while big-spending politicians proclaim that "we can't afford" a tax cut.

Corporate Welfare Creates an Uneven Playing Field. By giving selected businesses and industries special advantages, corporate subsidies put those with less political clout at a disadvantage.

Corporate Welfare Fosters an Incestuous Relationship between Business and Government. All too often, the firms and industries that contribute the most to political campaign coffers are the largest recipients of government handouts.

Corporate Welfare Programs Are Anti-Consumer. Programs like the sugar subsidy program cost consumers several billion dollars a year in higher prices.

Corporate Welfare Is Anti-Capitalist. As Wall Street financier Theodore J. Forstmann has put it, corporate welfare has led to the creation in America of the "statist businessman," who has been converted from a capitalist into a lobbyist.

Corporate Welfare Is Unconstitutional. Corporate subsidy programs lie outside Congress's limited spending authority under the Constitution. Nowhere in the Constitution is Congress granted the authority to spend taxpayer dollars to subsidize the agricultural industry, to enter into joint ventures with private companies, or to guarantee loans to favored business owners.

In reality, the best thing government can do to promote economic growth is to simply get its clumsy hand out of the way, and let private entrepreneurs with their own capital at risk determine how the economy's resources will be directed. That creates a level playing field, which minimizes governmental interference in the marketplace, and dramatically reducing the overall cost and regulatory burden of government. IPI

Dean Stansel is an associate policy analyst at the Cato Institute.

What about TAX Loopholes?

While some argue otherwise, allowing a company to keep more of its own earnings is not a form of welfare. It is that company's money after all. Calling such loopholes "corporate welfare" only makes sense if you believe that all money belongs to the government, and thus any portion that government allows us to keep is a gift.

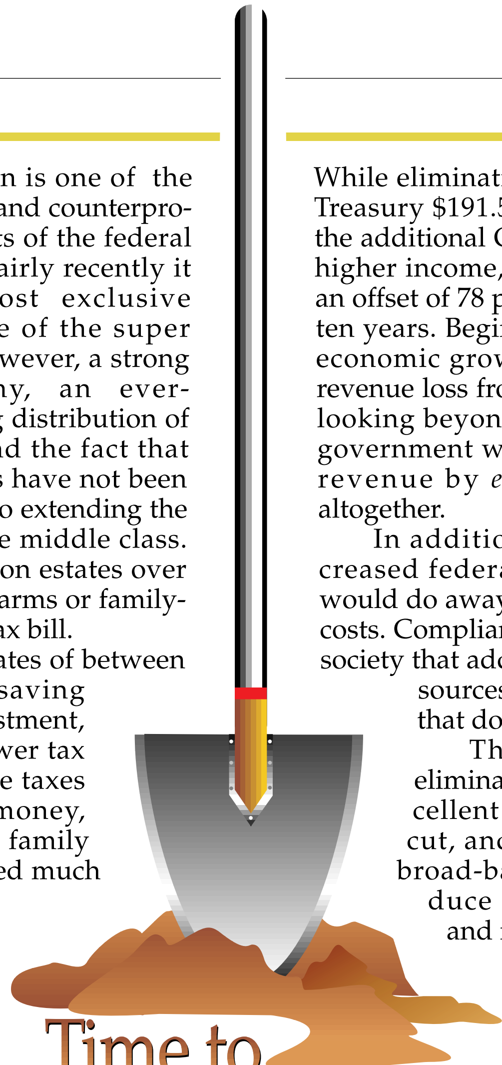
While targeted tax breaks are not corporate welfare, they certainly are bad tax policy. They suffer from the very same flaws as corporate welfare spending programs and should also be eliminated.

However, closing tax loopholes without simultaneously reducing tax rates — as many corporate welfare opponents recommend — would put billions more dollars into the hands of the federal government. American businesses are certainly over-subsidized, but they are also over-taxed and over-regulated. The last thing we need is a tax hike.

Time to Bury the Estate Tax

Estate taxation is one of the most arcane and counterproductive parts of the federal tax code. Until fairly recently it was the almost exclusive headache of the super rich. However, a strong economy, an ever-widening distribution of wealth, and the fact that estate tax rates over the years have not been indexed to inflation have all led to extending the grab of estate taxes well into the middle class. High marginal tax rates of 37% on estates over $600,000 often force heirs to sell farms or family-run businesses to pay the estate tax bill.

Further, high estate tax rates of between 37 and 55 percent discourage saving which, in turn, leads to less investment, slower economic growth and lower tax revenues. The irony is that estate taxes actually cost the government money, while severely penalizing small, family owned businesses that have fueled much of the current expansion.



Typically, those who are likely to pay the highest tax rates are those with medium sized inheritances. These are passed down from owners of small businesses and family farms who amass wealth during their lifetimes through hard work and thrift. Because such wealth is often unexpected, these people may not be aware of (or take full advantage of) ways to reduce taxes. In contrast, the very rich who have inherited their wealth routinely plan ways to mitigate the death tax through careful estate planning.

What would happen if federal estate taxes were eliminated altogether? First, it would cause the economy to grow faster because it would induce more saving and investment. Using our model of the U.S. economy, we have estimated that if the federal estate tax were eliminated in 1999, then by the year 2010:

> "Eliminating estate taxes should more than pay for itself with higher growth"

- Annual GDP would be $117.3 billion, or 0.9 percent above what it would be with the tax.
- The stock of U.S. capital would be higher by almost $1.5 trillion, or 4.1 percent above the baseline.
- Between 1999 and 2008, the economy would have produced $700 billion more in GDP than otherwise.

While eliminating the estate tax would cost the Treasury $191.5 billion between 1999 and 2008, the additional GDP would yield $148.7 billion in higher income, payroll and other federal taxes; an offset of 78 percent of revenue loss in the first ten years. Beginning in 2006 revenue gain from economic growth would more than offset the revenue loss from eliminating the tax. Therefore, looking beyond the first ten years, the federal government would actually collect *more* total revenue by *eliminating* estate taxes altogether.

In addition to economic growth and increased federal revenue, eliminating the tax would do away with extremely high compliance costs. Compliance costs are a deadweight loss to society that add nothing to output and divert resources away from productive activities that do.

The high economic payoff from eliminating the estate tax makes it an excellent candidate for a pro-growth tax cut, and should be one element of any broad-based tax reform that aims to reduce the double taxation on saving and investment.

While the estate tax was intended to prevent concentration of wealth, ironically the largest estates do not pay the highest taxes. That dubious honor falls on small and medium sized estates, often belonging to people who have started successful businesses.

Apart from the fairness issues, estate taxation hurts the economy. Its sheer complexity results in high compliance costs.

Estate taxes have hit small businesses — which have fueled much of the economic expansion —particularly hard. Heirs must sometimes liquidate a successful enterprise just to pay the estate tax bill.

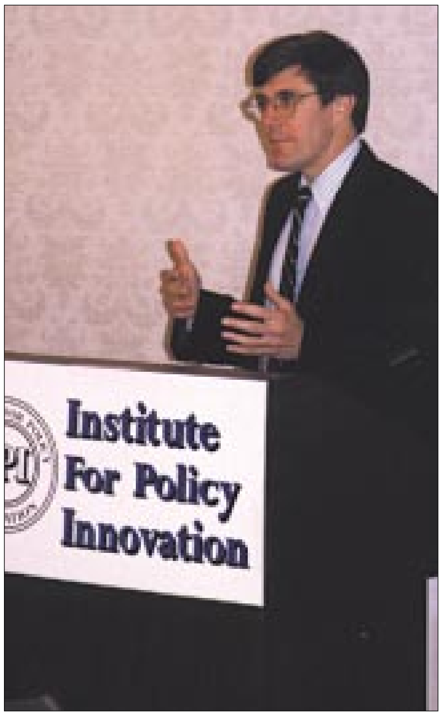
Because bequests are a primary motive behind saving, high tax rates on estates raise capital costs and depress savings and investment. Because capital is so important to the economy, eliminating estate taxes should more than pay for itself with higher growth.

All in all, American taxpayers, the economy and government would be better off without estate taxes. Their elimination could be one of the best legacies the 106th Congress could leave future generations. IPI

This article was taken from IPI Policy Report #150, entitled The Case For Burying the Estate Tax, *by Gary and Aldona Robbins. Copies are available upon request, and are also available on our website at www.ipi.org.*

Stephen Moore Speaks at IPI Luncheon

Stephen Moore, Director of Fiscal Policy Studies at the Cato Institute, was the featured speaker at a luncheon hosted by the Institute for Policy Innovation in Dallas on January 27th. A strong advocate for free markets and limited government, Moore discussed the programs currently in front of Congress, including social security privatization and broad based as well as targeted tax cuts. IPI



Steve Moore of the Cato Institute discusses legislative and policy issues for IPI's luncheon guests.

Cary Maguire and Bill Murchison at IPI's January luncheon.

Vance Miller (r) joins IPI president Tom Giovanetti (center) in welcoming Steve Moore to Dallas.

Advancing the Cause

IPI recently hired Kerri Houston as its first Director of Marketing and Development, shown here with IPI founder Congressman Dick Armey.

Ms. Houston's expertise will assist IPI in further leveraging its studies and expanding its influence in the public policy arena, as well as helping to devise a long-range development plan. IPI

Don't Forget About Corporate Matching Contributions

If your company makes matching corporate contributions to non-profit organizations supported by their employees, IPI fully qualifies for such programs. This is a great way for you to leverage your support for IPI, and to get your employer to support an organization you believe in.

Ask your H.R. department for information on your company's corporate matching program, and don't forget to remember IPI! IPI

Calendar of Events

March 17	**Capitol Hill**	**Estate Tax Briefing** Senators Ashcroft & Kyl; Reps. Dunn & Weller
April 30	**Dallas**	**Luncheon Panel Discussion** "Burying the Estate Tax" Gary & Aldona Robbins Rep. Pete Sessions (t/b/c) James Olan Hutcheson (t/b/c), ReGENERATION Partners
May 11	**Dallas**	**Luncheon and Book Signing** Amity Shlaes *Wall Street Journal* author of *The Greedy Hand: How Taxes Drive Americans Crazy and What to Do About It*

Please call 972-874-5121 for further information or reservations.

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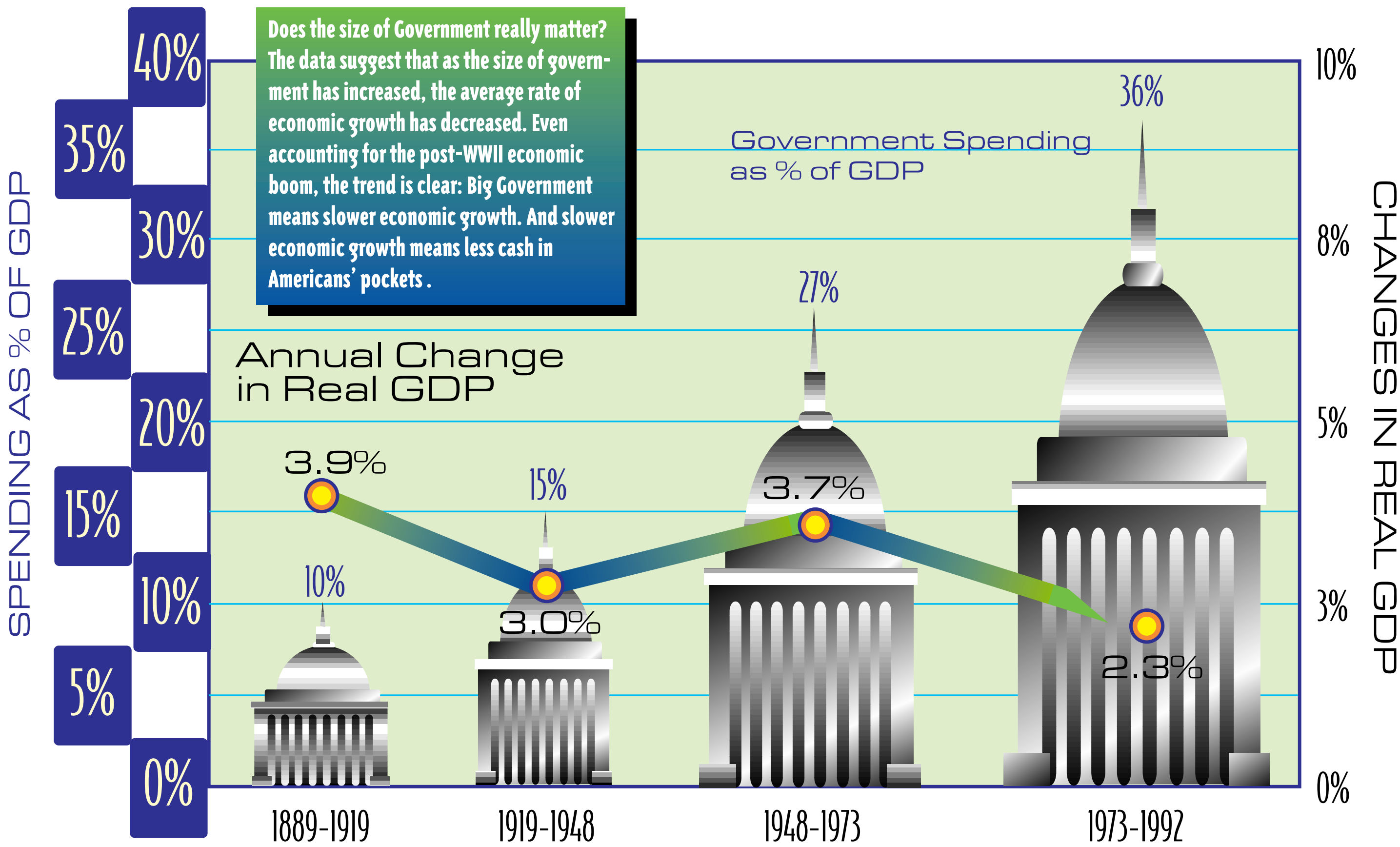
As the Government Grows, the Economy Slows



PARTING SHOTS

Iowa's attorney general has started an investigation of companies that sell candy cigarettes. Anti-smoking activists claim these candies entice children to smoke. But it isn't exactly clear what laws the candy makers may have broken. Still, if the state of Iowa takes action, it could start a trend. Maybe next someone could investigate the makers of wax lips under the theory that they encourage children to have unnecessary collagen injections.

Charles Oliver, **Reason Magazine**

[Regarding privatizing Social Security] " Some people in this country have told me, 'The idea is good, but people don't know how to manage money.' I am always puzzled that they trust people to choose among contending presidential candidates with positions on complex domestic and foreign affairs, but they don't trust them to invest their own money."

José Piñera, **Cato Policy Report**

"It is our money, not the government's. We make it. They take it. We have a right to determine who can better spend it. The president doesn't think we would act responsibly if allowed to keep more of our money. He is the last one who should talk about acting responsibly."

Cal Thomas, **Los Angeles Times**

A recent Oppenheimer Funds survey found that 84 percent of 18 to 34 year olds favor giving workers a choice of where to invest their Social Security taxes. Of that group, 80 percent say they are very concerned or somewhat concerned over whether they will have a financially secure retirement. About 53 percent think they will outlive Social Security, and many think they'd get a better return on their money by betting $1,000 on the Super Bowl than by paying it into the Social Security system.

Elsa Arnett, **San Jose Mercury News**