

Reforms take the security out of Social Security: JOSEPH STIGLITZ:: [LONDON 1ST EDITION]

STIGLITZ, JOSEPH. *Financial Times* [London (UK)] 21 Mar 2005: 17.

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Details

Translate

The challenge posed by the impending retirement of the baby boomers and the potential financial problems facing Social Security in the US are widely acknowledged. While George W. Bush has not provided the details of his reforms, it is clear that the president intends to take both "security" and "social" out of Social Security. The programme that has done so much to eliminate poverty among the aged will no longer be up to the task, as individuals are left more vulnerable to the vagaries of inflation and markets. Depending on the exact details of the reform, the "guaranteed" annual income for future retirees may be as low as Dollars 5,000-Dollars 10,000 (Pounds 2,600-Pounds 5,200) at today's value. Changing from wage to price indexing of benefits, as is proposed, seems innocuous but if productivity continues to grow, and wages grow commensurately, the gap in living standards between the elderly and the rest will increase.

This is a high price to pay. But will the reforms prepare America better for the problems of the baby boomers? The answer is no. There are three key issues. What will happen to the deficit? What will happen to national savings? What will happen to the financial solvency of the remnants of the Social Security system? Individual accounts do little in any of these three areas, and may make matters worse.

Diverting almost one-third of Social Security revenues from the government to private accounts will increase the deficit enormously - by some Dollars 1,500bn in the first decade and Dollars 5,000bn in the next. Alan Greenspan, Federal Reserve chairman, has warned against increasing the deficit by more than Dollars 1,000bn, but Mr Bush's supporters say this is just book-keeping - markets already take these implicit future liabilities into account and formal recognition will make no difference.

This is nonsense. There are huge uncertainties. The administration's calculation of the magnitude of the Social Security deficit is barely credible. It uses the remarkably conservative projection for gross domestic product growth of 1.8 per cent. If productivity continues at the pace of the past decade, a more reasonable figure would be almost twice as high. It assumes that the number of migrants is constant; if migration flows continue at current levels, the deficit over the next half-century is greatly diminished, as their contributions are added. There is considerable uncertainty about life expectancies; if America's increase in obesity continues, life span may even decrease, which, as bad as it is in other respects, would help the solvency of Social Security. There is also uncertainty about the extent of improvements in future government implicit liabilities. Who really believes that in the worst-case scenario there would not be a government bail-out? Most importantly, an explicit deficit has to be financed today - putting enormous

demands on global capital markets, raising real interest rates. If all of the money that had been used to finance government borrowing now goes into equities, who will buy US treasuries? To keep interest rates from rising, will the Fed flood the world with liquidity?

But this is where the reform's defenders put forth a second specious argument: savings will be increased. If they rise enough, there will be no trouble financing the deficit. But the worry is that they will decrease. The best argument on the conservative side, the Barro-Ricardo hypothesis (after David Ricardo, the great British economist, and Robert Barro of Harvard), is that taxpayers understand future tax liabilities, so when government increases borrowing, they increase savings. My own research showed the result was only true under highly restrictive - and unrealistic - assumptions. Even as the US fiscal deficit has soared during the past four years, the household savings rate has plummeted.

Under the Barro-Ricardo hypothesis, substituting the concrete upfront deficit for the implicit and uncertain future liabilities would have no effect on national savings. But many Americans are more likely to attach more weight to their highly visible private accounts than to the Social Security benefits they are intended to replace, so national savings are likely to decrease.

None of this should be surprising. The Bush reformers wanted to pull a rabbit out of a hat, simultaneously making the aged better off and improving the fiscal position of both Social Security and the government. If, as the reformers believe, markets work well, the higher returns offered by equities come at a price: higher risk. If there is a problem with Social Security's solvency, individual accounts do not fix it; and cutting revenues by one-third is hardly a promising start for restoring fiscal solvency. There is no magic. Either benefits have to be cut or revenues increased, and this is true with or without private accounts. We should not confuse the two issues.

If there is a remarkable achievement of the Bush proposals, it is this: they simultaneously undermine the solvency of the Social Security system, worsen the fiscal deficit, diminish the security of the elderly and increase the incidence of poverty.

The writer is University Professor at Columbia University and was awarded the Nobel Prize in economics in 2001

Word count: **847**

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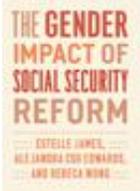
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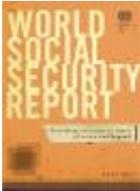
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