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FIXING SOCIAL SECURITY

December 16, 2004



Ray Suarez leads a discussion on the best way to reform Social Security with two public policy experts.

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RAY SUAREZ: It was former Speaker of the House Tip O'Neil who called Social Security "the third rail of American politics" because it meant certain death to any politician who touched it.



some principles, during day two of his economic summit.

PRESIDENT GEORGE W. BUSH: It's very important for seniors to understand nothing will change. In other words, nobody's going to take away your check. You'll receive that which has been promised. Secondly, I do not believe we ought to be raising payroll taxes to achieve the objective of a sound Social Security system.

Thirdly, I believe younger workers ought to be able to take some of their own payroll taxes and set them up in a personal savings account, which will earn a better rate of return, encourage ownership in savings, and provide a new way of... well, let me just say reforming... modernizing the system to reflect what many workers are already experiencing in America, the capacity to manage your own asset base that

But during the election campaign, President Bush vowed to do just that in his second term, arguing now was the time to reform the Social Security system before it became insolvent. Today the president repeated that pledge, and laid out

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government cannot take away.

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And so with those principles in mind, I'm open-minded with...(laughter) ...with the members of Congress.

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How large the social security problem looms

RAY SUAREZ: A closer look now at the problems with Social Security financing. For that, I'm joined by Maya MacGuineas, president of the Committee for a Responsible Federal Budget at the New America Foundation; and Kenneth Apfel, public affairs professor at the University of Texas -- he was the commissioner of the Social Security administration from 1997 to 2001.



Well, if we did nothing the law is very clear. Benefits would continue for about the next 40 years in their current form. But starting in about 40 years, benefits would be reduced by about 30 percent. So clearly, taking action in the medium term is a very good thing to do.

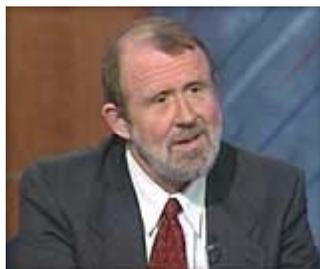
KENNETH APFEL
University of Texas

Professor, earlier today the president said the first issue is to explain to Congress and the American people the size of the problem. So why don't we start there? What is the size of the problem? How bad a trouble is Social Security in?

KENNETH APFEL: Well, Social Security does face long term challenges, Ray. The number of seniors is going to double in the next 30 years and that's going to create some real strains on our retirement system. This is not Armageddon at all.

Basically the revenues coming in to Social Security will cover about three quarters of all benefit obligations. So we do face a challenge. But it's on the order of magnitude of about two thirds of a percentage of GDP over the next seventy/eighty years. So this is not massive.

RAY SUAREZ: So what would happen if we did nothing?



KENNETH APFEL: Well, if we did nothing the law is very clear. Benefits would continue for about the next 40 years in their current form. But starting in about 40 years, benefits would be

reduced by about 30 percent. So clearly, taking action in the medium term is a very good thing to do.

The last thing we should do is to wait 30 and 40 years to resolve this issue. There's no short-term crisis, I don't think there's really a long-term crisis. But we do have to take some actions now to get the system stronger.

RAY SUAREZ: Maya MacGuineas, what does the Social Security system today and into the future look like to you?

MAYA MAC GUINEAS: Well, clearly doing nothing is not an option, because we know right now the system has promised to pay far more benefits than it will collect in revenues, so we need to make changes by bringing those two revenue and benefit streams together.

We can postpone the choice to do that, pushing all those tough choices into the future, or we can start to do them now, which allows people to prepare for the changes and allows us to phase them in gradually. I also think that because we've known about this problem for quite some time, we should have you done this earlier.

It's not something you want to kick the can down the road on, it's something that you want to address in a responsible way so that citizens know what they can expect from Social Security and find a way also to be saving on their own if that's part of what they need to do for their overall retirement security. It's not something we want Congress to continue to avoid addressing.

RAY SUAREZ: You just heard the professor describe it as a problem but not a great big one. Do you agree with that?

MAYA MAC GUINEAS: I think it's probably a little bigger than he said. There's a lot of different ways to look at it. I don't mean to say anything he said was incorrect, it's all correct. But the problem will grow over time.



So for instance, over time, Social Security will grow by about 50 percent of its current share of GDP. Or put it another way, if we wanted to put aside all the resources today that would allow us to make good on the promises that we've made in the future over the next 75 years, beyond what the taxable rate is for the program, we'd have to put aside about three and a half trillion dollars.

That's far more than we have available in the economy -- we're well over promising. And that's a problem because whenever we do address it we're going to take a hit on either the benefits side or the tax side.

An 1980s reform model

RAY SUAREZ: Well, the last time the system was perceived to be in very big trouble in the early 80s, they did several things. They raised the amount of payroll tax people pay, they gradually started to raise the retirement age.



And they also raised the amount of tax they collect on the benefit checks that people were getting and by doing that, postponed what was called the inevitable for a long time. Are the solutions that face us now as easy as then?

MAYA MAC GUINEAS: Well, they're the same kinds of choices, exactly. What they did is they grappled with what's the right balance of benefit reductions and tax increases to apply to the program. And they made choices on both sides, and they raised the retirement age, something which makes an awful lot of sense because we're all living much longer than we did when the program began.

What they also did, though, is they built up programmatic surpluses and they saved them into Social Security trust funds and that might be where I would say those reforms shouldn't be the model for what we do going forward because by saving all those additional monies that we brought in through the Social Security system in a government trust fund, where the dollars end up getting co-mingled with other government money and inevitably allow people in Congress to feel like the money there's to spend and

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MAYA MAC GUINEAS
*New American
Foundation*

they spend it, the money doesn't really get saved.

And so what I think we need to do those same kinds of choices. Again, there's no free lunch here, but we need to find a better way to store them, make sure the money is all safe for Social Security. I would say that was one of the shortcomings of the previous round of reforms.



RAY SUAREZ: Professor, did that create part of today's situation, that idea that you could use that money that was collected in excess of what was being paid in benefits?

KENNETH APFEL: Well, actually the changes in 1983 were incredibly important, a very big step in the right direction that put the system on a path to be resolved for about 40 years, maybe even 50 years. That's not a bad solution; I think it was one of the best things that the Congress did during the 1980s was to make a big step in this direction.

There's another step we have to take, there's another whole round of issues that need to be resolved with Social Security, another round generally on the same order of magnitude as were made back in 1983. I tend to think that we're going to need to see some changes get made in both the tax side and the spending side, and Maya and I generally agree with that; I don't think these have to be the least bit dramatic.

And I think that building some trust funds I think is a good thing for the Social Security system, so that basically there's some reserves there when people need them.

RAY SUAREZ: Now, when the 1983 plan was unveiled, it was said at that time it was going to keep the system solvent into the middle of the 21st century. Now the trust fund is said to be on its way to running out of money in 2042, the Congressional Budget Office says 2052.

Are these assumptions so far right? Are the things that they thought were going to happen in '83 by making the adjustments they made actually coming true? And does that tell us something about what needs to be

How much of a foundation do we want Social Security to be -- that's the corner stone question that we have here. And that's the big debate that's going to take place: Whether to have a foundational benefit that provides a modest level of support over a lifetime, whether one lives to 65 or 105. And combined with that, how much risk do we want on everything else?

KENNETH APFEL
University of Texas

done to push off a day of reckoning even further into the future, Maya MacGuineas?

MAYA MAC GUINEAS:

Well, there are a couple things about what they were thinking when they made those changes and what has happened. First, most of their analysis was over the shorter term, so over a decade; they didn't really look as far into the future with sophisticated analyses as we do now.



Second, they never really anticipated that the trust funds would build up such large surpluses, and many of the people who are involved in those reforms look back and say the trust funds didn't work. We made the right kinds of policy choices, but the wrong kinds of mechanical choices, putting all this money in a government trust fund in order to really shore up the system.

And you talk about some numbers about when those trust funds will be depleted. But I don't think those are the only important numbers to think about. We need to, one, consider that the baby boom starts to retire in 2008. We are bumping up against the first retirement of the baby boom. This is not something we should be pushing down beyond that.

And two, cash flow deficits, when Social Security will no longer be able to pay for its bills from the taxes it raises, and it has to go to those government trust funds, but because all that's in there is debt we have to find a way to pay for that debt or refill those trust funds, we have left ourselves with some tough choices that are coming much sooner in about ten, fifteen years, it's not decades that I think we can wait to make these choices, we're really just talking about things around the corner.

How to reform Social Security financing

RAY SUAREZ: Tough choices that result in what kind of decisions, Professor? What are the kinds of things that are going to have to be considered?



KENNETH APFEL: We heard the president say to

allow the diversion of some of the Social Security payroll taxes into individual savings accounts and no increases in payroll taxes. To me I think that's a recipe for dramatic and radical change to the system that I think is not called for at all. This is a significant challenge that we face, but it's not Armageddon, as I said.

What the president has talked about are some things that I think lead to potentially a reduction in the guaranteed Social Security system, about half over the long- term. We'll see when the details come out. And I want to look very carefully at those details. But what he wants to do is propose shifting and radically reducing the Social Security guaranteed benefits and replacing that with individual accounts.

I don't think the size of the problem is anywhere near that big to go for that. I think that instead some modest revenue increases, some modest reductions in programs, I've been saying for years, would be sufficient to keep the system solvent for years and years and years into the future.

RAY SUAREZ: Are those solutions for you?



MAYA MAC GUINEAS:

Those are the right kinds of solutions, I see it slightly differently. First, you need to understand that the way Social Security benefits are calculated, they are indexed twice, every year for people who are receiving their benefits they grow with inflation so that inflationary costs are covered.

But also they're indexed for wage growth, which means when you retire your benefit is bumped up for how the economy grew while you were a worker.

So one of the kinds of options we could think about is instead of double indexing those benefits, just price indexing them, which means my father would get the same benefit that my grandmother is getting today, and I would get the same benefit that he's getting in terms of our purchasing power. It would grow with inflation, but not more. That one change would make a big difference.

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MAYA MAC GUINEAS
New American
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Another kind of thing we should be considering is lifting the payroll tax cap. So we might pay Social Security taxes above the cap where it currently is. You don't have to eliminate the cap, you don't even have to pay the full 12.4 percent tax on it, but you might want to get more revenues in that way, especially if you're thinking about private accounts and you need some up front money.

RAY SUAREZ: But isn't that just the kind of tax increase that the president said he wouldn't consider?



MAYA MAC GUINEAS: I'm not saying that this is the kind of proposal the president would absolutely love. I think we need to talk about having revenues and benefit reductions on the table. I think we need bipartisan support, I think we need changes that are big enough that both are necessary. And just a third option that really we should think about is either indexing benefits for growing life expectancy or increasing the retirement age because it makes little sense for us to think we can afford to be supported in retirement for so much longer than the program used to expect we would live.

RAY SUAREZ: But that's a political decision, I guess, not strictly an actuarial one, one that's made about dollars and cents and mechanics.



KENNETH APFEL: That's very much of a political decision and some of the proposals would lead to a benefit structure that would be so low that we could really see the elderly at risk at that point in time; this is future generations of elderly.

I'm concerned that if we start to lower the benefit package to that level so that our children are only receiving the same purchasing power that we're receiving, given the growth in the economy, part of that should come from higher benefits for people to be able to live an adequate life in retirement.

How much of a foundation do we want Social

Security to be -- that's the corner stone question that we have here. And that's the big debate that's going to take place: Whether to have a foundational benefit that provides a modest level of support over a lifetime, whether one lives to 65 or 105. And combined with that, how much risk do we want on everything else?

Some of the proposals that are out there put a lot of individual risk in the responsibility on individuals to save for their retirement, and a way for them to collect it and be able to provide that solid foundation, I think that's dangerous.

RAY SUAREZ: Professor Apfel, Maya MacGuineas, thank you both.



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