



## Railroads and Politics

by Glenn E. Atkins, CFA

It is a rare feat in politics that anyone, democrat or republican, grabs the third rail of politics and survives, which makes the vision of social security reform the perfect issue for a second-term president. The fact that we are even having a national discourse on reform is testament enough to the belief that this mother-of-all-social-programs is in serious, even grave, trouble. We are talking about it, and searching for solutions, and yet no one has been “shocked” permanently back to their home political districts.

In order for me to cover this dangerous topic effectively, we all have to leave our politics at the door for the remainder of the article. Take off your democratic hat; take off your republican hat, let’s pour some lemonade, sit on the back deck and just talk for a minute, as Americans.

Surely everyone will agree that social security as we know it is dead on arrival. No Virginia, there is no “lockbox”, there is no “Trust Fund.” Simple reality is painful sometimes. Between now and 2017 the social security payroll tax will generate at least \$2.2 trillion more than will be paid out, but it will be spent immediately by our friends in Washington on other, unrelated items. How’s that for creative accounting? Private-sector businessmen go to prison for less. Regardless of your political affiliation, all serious observers of our current social security program are aware that benefits cannot continue to be paid out as they are currently. It’s really just a math problem and unfortunately the math doesn’t work anymore.

The real problem with social security as it now stands is two-fold. First, as the baby-boom generation enters retirement, the number of workers supporting the number of retirees will drop by more than one-third to less than 2, versus 3 currently. Second, social security benefits are indexed to wage growth, not inflation (i.e., cost of living) and wages are growing 1% faster than inflation annually. According to the Wall Street Journal, retiree benefits will double in real, inflation-adjusted terms by 2077, making retirees two times better off than they are currently. That was clearly not the original intention of the social security mandate, to make people two times better off over the course of their retirement. Remember that guaranteed annual increases were not introduced until 1972, long after Roosevelt, as both political parties pandered for elderly votes. It doesn’t take long under these scenarios for the system to become bankrupt.

Fortunately, there is a simple solution but partisan politics continues to rule all things Washington. Robert C. Pozen, Chairman of MFS Investment Management, has proposed a solution he calls “progressive indexing.” Under his proposal, workers making over \$113,000 per year would have their benefits indexed by inflation (remember, not wages

as is currently done). Workers making less than \$25,000 per year would see their benefits continue to be indexed by wages and benefits for workers making between \$25,000 and \$113,000 would be indexed by a combination of wages and inflation. Thirty percent of wage earners – those already in retirement, those retiring before 2012, and those with average career wages of \$25,000 or less – would see no change in expected benefits. It’s the perfect world. Workers with earnings below \$113,000 would see their benefits rise in both real and nominal terms and workers with earnings above \$113,000 would maintain their standard of living during retirement.

His plan, if adopted and combined with modest personal retirement accounts (PRA’s), would allow social security to become solvent and self-funding at the end of seventy-five years. Mr. Pozen’s plan would allow workers to allocate 2% of their FICA wages to their own PRA. Don’t forget that PRA’s would be owned by individual workers and would be inheritable. If you were to die now at 62 you would never reap any of the taxes you paid in. Government borrowing would go up initially under Pozen’s plan, but would ultimately be lower in later years because workers electing to use PRA’s would receive lower social security benefits because they would also have available to them the money and earnings that they contributed and earned on their own PRA’s.

This is truly a situation where everybody wins. Benefits for those in or near retirement or for low wage earners are maintained, social security is made solvent, benefits for high wage earners keep pace with inflation, and government debt will decrease by \$2 trillion from what it will otherwise have to be. The best thing is you and I will not be bankrupting the future of our grandchildren because we were afraid to act boldly now. If we can do it – if we can act boldly now, that will be our greatest legacy to our nation and future generations.

Now you may put your political hat back on. The “Big Con”, as the Wall Street Journal put it, that is “being peddled by the AARP...is that if nothing is done the government can simply raise taxes ad infinitum to pay for benefits, even as they know this is an economic and fiscal impossibility.” Everyone will agree that it’s in our best interest to fix this mess that has become social security. It really is an easy choice, but it requires leadership. Whether you like President Bush or not I don’t care, but don’t fault him for lack of leadership. In order for us to fix social security we need to change our thinking from democrat or republican to American. We are all in this together and either we fix it together or we bankrupt the greatest nation on earth together. I choose to fix it.

One final note – “American” solutions to this problem do exist. Robert Pozen, whose ideas we discussed above, was also one of the democrats on President Bush’s Social Security Commission. ■

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