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Don't Make The Kids Pay For Our Mess

Social Security's would-be privatizers differ on the details, but their common refrain is that altering the system will help young and future generations. At his recent economic forum, President Bush pointed to Social Security's $10.4 trillion funding gap and asked, "Are we willing to confront the problem now or are we going to pass it on to future Congresses and future generations?"

The president's concern about fiscal child abuse is well placed. But the chasm separating Social Security's future benefit commitments and its future payroll tax receipts is just a part of the story. There is a much larger fiscal gap separating total projected federal expenditures (including debt service) and total projected federal taxes. The size of this red hole was calculated by Treasury officials two years ago at $45 trillion. Their current estimate is $6 trillion larger thanks to the president's 2003 tax cut and the new Medicare prescription drug benefit.

Numbers this big are mind-boggling. Some say these bills won't come due for decades and can be paid when the economy and its tax base are much larger. Unfortunately, that's not the case. The $51 trillion figure represents the amount of money we'd need to have *today* to avoid raising taxes or cutting spending down the road. Think of it as Uncle Sam's credit card bill, which gets bigger the longer he waits to pay it. Indeed, the fiscal gap will likely grow by $1.5 trillion in the coming year.

So the trillion-dollar question is: Who will pay this gigantic and growing bill? Will it be we adults or our kids, including kids not yet born?

Intergenerational equity suggests spreading the burden across all generations via, for example, an immediate and permanent hike in both federal corporate and personal income taxes. How big would that tax hike need to be? The answer is a whopping 78 percent!

Inflicting pain of this type on current adults isn't exactly PC. So what about dumping the entire $51 trillion bill in our kids' laps? Well, that isn't exactly moral. Nor is it feasible. We'd have to double our kids' net tax rates (the share of their earnings they would pay to the government minus anything the government pays them back in benefits) compared to the rates we adults face. With fiscal burdens that high, our kids would stop working, evade taxes and leave the country.

Unfortunately, the dirty little secret underlying most Social Security privatization schemes is that they head precisely down this road. Take the second of the three plans developed by the President's Commission to Strengthen Social Security. This plan, which the president is likely to endorse, pegs increases of Social Security benefits to price inflation rather than wage inflation. (Wages usually rise faster than prices overall, so this means benefits would rise more slowly.) It also lets workers invest some of their payroll taxes in private accounts.

The indexing wipes out a large and growing portion of the benefits promised to our kids. And the option to invest comes at a big penalty. According to the fine print, every dollar invested leads to a further loss of Social Security benefits equal to that dollar compounded at a 2 percent rate of return after inflation. If our kids invest in a safe manner, they'll be lucky to earn 2 percent after inflation. Indeed, the current real yield on long-term inflation-protected U.S. Treasury bonds is less than 2 percent.

The investment option is no real option at all. It's a side show to divert attention from the main point of the plan -- wiping out most of our kids' benefits and thereby raising their net taxes. Those who don't invest will end up paying the same payroll taxes, but receive far less in benefits. And those who do invest will end up paying lower payroll taxes, but will suffer additional benefit losses that actually exceed the value of their payroll tax reduction.

Fixing Social Security is imperative. But doing so by eating our young is hardly the answer.

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