Why Does the Government Patronize Us?

By Edward C. Prescott

Radicals: The creation of temporary inte-

racts into the affairs of today.

—Andrew Bacevich, "The Devil's Diplomat"

of all the economic issues facing Washington these days, one stands higher and more than any other without a solution—our Social Security problems. We often hear that the main problem is our aging demographics or the political gaffes that are played with Social Security myths. While there may be problems inherent, they are only symptomatic of the funda-

mental predicament: Government has made promises that it can't keep.

Herein lies the governmental solution has al-

ways been to make more promises. "Don't worry. We'll figure something out. You'll get your Social Security payments. Trust us!" But to savvy citizens these are starting to point toward the same outcome. Easy to roll, Social Security will be broken. Indeed, Social Security benefit payments are projected to exceed payroll tax revenue in the year 2028, with Social Security trust fund depletion to occur in 2030. I would hate to be a politician in office when this pie crust breaks.

The time is right to act, and we don't need a special commission to analyze the problem and recommend solutions because we already had one, and it submitted its report three years ago next month. —The President's Commission to Strengthen Social Security. The trouble is that little has happened since. It's time to dust off that report, jettison our policies and get to work on refurbishing our Social Security system before it's too late.

The moral conviction of that 2008 bipartisan committee was that we need to reestablish the equilibrium of a system of voluntary personal accounts, which would increase indexed savings as well as in-

crease labor-force participation—more on that later. But this committee also recognized the nation's aging Dow, by the personal sector is far enough.

We need to establish a system of manufac-

turing savings accounts for everyone. With-

out mandatory savings accounts we will not relieve the inter-temporary problem of people under-saving and becoming a burden far-

on their families and on the taxpayers. That's exactly where we are now.

Before I describe the benefits of such ac-

counts, let's begin by dismissing the notion that individual savings plans are somehow danger-

ous to U.S. citizens. Some quibbling? I don't want to get into the debate whether investment is good or bad, and I'll leave that for others. And I do not want to discuss whether these benefits are sufficient to warrant the creation of a system of Social Security. But it should be clear to any rational observer that the idea of giving investment freedom to citizens, arguing that these citizens will be ex-

pected to save in the same market. But it is not the public as a whole that makes appro-

priate decisions. Ordinary citizens do not have the information and the time to make wise decisions and will not be able to use the services that the government will be offering.

So how would such a re-

formed system work? Here's a proposal: Have three quar-

ters of employers and emp-

loyees Social Security contributions (cur-

rently 12.4%) of wages, and remit their em-

ployees' income up to a maximum of $25,000 to inde-

pendent savings ac-

counts. This would be delayed income, paid at a rate that would provide a prop-

or rate of return, and be available only to individuals who have retired.

The economy will have more productive assets, which also contributes to more production.

Regarding labor tax, any system that taxes people when they are young and gives it back when they are old will have a negative impact on labor supply. People will simply work less. Paid a different way: if people are in control of their own savings, and if their retirement is not funded by savings rather than transfers, they will work more. Everyone is better off.

There are the type of win-win situations that politicians and policy makers should be falling over themselves to accomplish.

And those policy makers need to get beyond the idea of creating only voluntary savings accounts. Voluntary accounts are not the full answer. There is nothing wrong with making a responsible few of us pay for saving the Social Security system is mandated, but it is sure to be mandated. A new system in a private system would have to be set up. The new system, in a private system would have to be funded by the individuals who are taking out of their wages.

Some analysts have suggested that we can't move from a transfer system to a saving system because current retirees will be left in the lurch. This will pay for them if workers' money is not only shifted to individual tax accounts. There will indeed be a period of time, likely no more than 10 years, in which narrowly defined government debt relative to gross national income would increase before decreasing. But government debt is small relative to the present value of social Security promises that currently exist. Further, the sum of these retirement tax credits and the value of these promises will start declining immediately.

Under a reformed system there will always be some individuals who, owing to disabilities or other reasons that prevent them from working, will not have sufficient savings in their old age. The solution is to include a matched-contribution plan to ensure that those citizens receive a re-

And the individual savings accounts are transparent in practice.

The beauty of such reform extends beyond the individual accounts of U.S. citizens (although not as rea-

sonable for reform) — they also ac-

count for the economy. As noted above, Social Security savings will rise, which will prop-

er to the economy. On the first point, more savings means there will be more capital, which will have a positive impact on wages, which benefits the working people. The other points are self-evident. As the economy will have more productive assets, which also contributes to more production.

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