Seniors Against Federal Extravagance

www.s-a-f-e.org

April 11, 2005

Via Fax

The Honorable John Doe
U.S. Senate
_______ Senate Office Building
Washington, D.C. 20510-0001

Dear Senator Doe:

One of the key issues in the current debate over Social Security reform is how to finance the transitional outlays for personal retirement accounts.

Since these outlays would represent the conversion of implicit debt to explicit debt and later be recouped, some economists say they could safely be borrowed. The amounts are substantial, however, and our government is already running up the national debt at a disturbing rate.

Accordingly, we believe that the time has come for Congress and the president to get serious about eliminating wasteful government spending. Potential savings on the order of $200-300 billion per year could be achieved without unfairly hurting people who need help or interfering with crucial operations. Raising taxes may seem more appealing to some, but tax increases of the magnitude required would have a devastating effect on the U.S. economy.

Perhaps our ideas will sound extreme, but remember that the fiscal affairs of our country are spiraling out of control, the hour is late, and a failure to respond effectively could lead to hyperinflation and a financial meltdown. You don't have to take our word for it, either, because some pretty smart people agree with us

For a more detailed statement of our views, please see the enclosed memo. We hope you will find the memo helpful and would appreciate your support.

Sincerely,

Social Security Reform

Seniors Against Federal Extravagance (SAFE) believes that the fiscal gap for Social Security must be closed. In addition, we support giving younger workers the option of directing some of the payroll taxes they pay into Personal Retirement Accounts.

While our views may not be representative of the views of all seniors, we aren't convinced that the Washington office of the AARP can make this claim either. None of the reform proposals in play would affect the Social Security benefits of retirees and workers nearing retirement (born before

1950). It is hard to see, therefore, how the AARP's slick, multimillion dollar campaign against Personal Retirement Accounts is being driven by the interests of their membership.

The Fiscal Gap --When Social Security outlays begin to exceed tax revenues earmarked for Social Security, in 2017 or so, Congress will have three choices – cut benefits, raise taxes, or borrow to make ends meet (which at some point morphs into printing money).

Like Social Security, Medicare is being financed on a pay-as-you-go basis. If these two entitlement programs are viewed as a package, which seems logical since the growth of both is being driven by the same demographic trends, the shortfall has arrived already and it threatens to swamp the finances of our government within a few years.

And let's not forget the explosive growth of Medicaid, another entitlement program (supposedly only for the indigent) that pays for the health care needs (notably residence in nursing homes) of many seniors. Medicaid is financed out of general tax revenues (about 2/3 federal, 1/3 state). A lively debate was sparked by President Bush's proposals to modestly reduce federal spending for this program, which critics characterized as a scheme to push costs back on the states. "Medicaid Reform: The next big thing," The Economist, 3/5/05.

All things considered, here's how several experts have characterized our country's budgetary situation:

- *Laurence J. Kotlikoff, a Boston University economist:* In an 11/12/04 presentation to an economics seminar at the University of Delaware, Professor Kotlikoff said the United States is facing a fiscal gap (in present value terms) of $51 trillion. In effect, according to him, our country is "bankrupt right now" and "in worse shape than Argentina." If the problem is not addressed, look for hyperinflation and a fiscal meltdown within a few years. "It's happened in other countries, and we are not immune."

- *Peter G. Peterson, chairman of the Blackstone Group, chairman of the Council of Foreign Relations, and a founding president of the Concord Coalition:* In "Running on Empty," Farrar Strauss & Giroux (2004), Mr. Peterson explained why he wrote the book. "Because the hour is growing late. Because, while our problems are not yet intractable, both political parties are increasingly incorrigible. They are not facing the problems, they are running from them. They are locked into a politics of denial, distraction, and self-indulgence that can only be overcome if readers like you take back this country from the ideologues and spin doctors of both the left and right. I believe a critical mass of ordinary Americans now sense that the country is on the wrong economic course and are willing to do something about it. I fervently hope so. We can't expect politicians to do it for us. We the people must make it possible for politicians to do the right thing."

- *Federal Reserve Chairman Alan Greenspan:* In his 2/25/04 testimony before the House Budget Committee, Chairman Greenspan said the government's current deficit will worsen dramatically once the 77 million members of the baby boom generation start retiring in 2008. "This demographic change is certain to place enormous demands on our nation's resources – demands we will almost surely be unable to meet unless action is taken," according to Greenspan. "For a variety of reasons, that action is better taken as soon as possible."

- *Thomas Saving, a member of the Social Security Board of Trustees:* "This year," said Mr. Saving in an op-ed piece (Wall Street Journal, 3/8/05), "the combined deficit in Social Security and Medicare will require almost 4% of federal income tax revenues. That figure will double in the five years after. Ten years from now, the federal government will need one in every seven income-tax dollars to pay benefits, assuming no increase in taxes. By 2020, entitlements for the elderly will consume one in four income-tax dollars. By 2030 they'll consume one of every two. To put that in perspective, in less than 30 years, the federal government will have to cut programs paid for by federal income taxes in half. Either that or it will have to raise income taxes on the working population by 50%."

Personal Retirement Accounts – Here are three advantages that we believe personal accounts would offer:

- Mitigate the benefit cuts for future retirees that appear inevitable by giving them the advantage of financial market returns that, on average, should help them to accumulate an attractive retirement nest egg.

- Stop the diversion of Social Security tax revenues to other spending programs (which as matters stand will continue until 2017).

- Give workers an assured stake in the payroll taxes they are required to pay into the program, rather than forcing them to rely on promises of politicians who will be long gone when they retire as to the benefits they will eventually receive.

Concerns that personal accounts are a risky scheme and a bonanza for Wall Street can be allayed by following the model of the Thrift Savings Plan that is currently offered for all federal government employees.

Let's be clear about one thing. SAFE is not about to accept a phony "bipartisan compromise." A personal account add-on proposal (which instead of reforming Social Security would create a new entitlement) was reportedly sent to the President by 42 Senate Democrats. "'Adding-On' Entitlements" (editorial), Wall Street Journal, 3/95/05. In our view, this approach would exacerbate the problems with Social Security instead of fixing them.

Financing – The transition to personal accounts would necessitate substantial cash outlays, e.g, $2 trillion over a period of years. While such outlays would represent the conversion of implicit debt to explicit debt and later be recouped, we are not in favor of blithely running up the National Debt. Therefore, we would urge the president and Congress to get serious about <u>eliminating wasteful government spending</u>. For example:

- Rescind the prescription drug benefit for Medicare that was enacted in 2003 (and is scheduled to become effective in 2006). This new entitlement will cost considerably more than was estimated, it applies to all seniors (not only the indigent, who already have prescription drug coverage under Medicaid), and no one is happy with it anyway. After its repeal, a bi-partisan commission should be appointed to review our options for reforming the troubled Medicare and Medicaid programs before they bankrupt the country.
- Slash agricultural subsidies, which currently exceed $80 billion per year. Note that federal government subsidies account for nearly a quarter of all U.S. farm income, and the bulk of the subsidies go to large agribusinesses vs. small farmers. "Why Farm Subsidy Cuts Might Actually Stick," Business Week, 2/21/05.

- Eliminate "corporate welfare" and tax loopholes, which benefit the operations of individual firms/ narrowly defined industries. The potential savings is about $100 billion per year.

- End subsidies for Amtrak passenger service. The public clearly doesn't need rail passenger service from Salt Lake to Denver, etc., but if we keep subsidizing it we will have it forever. Passenger service in the Northeast corridor may be economically justified, but if so subsidies should not be necessary.

- Accelerate the shutdown of obsolete military facilities that the Pentagon does not need.

- Drastically prune "earmarked funds" for projects in individual Congressional districts, aka "pork," such as an $8.5 million program to celebrate the history of the U.S. whaling industry (three states benefit: Alaska, Hawaii, and Massachusetts). As one reporter put it, "With 535 senators and representatives in town, this is a place where almost no idea is so small, narrow or obscure that it can't find at least one sponsor who will turn it into a federal program. And often, that's also enough to keep it alive, even when the White House is gunning for it." Bush Tries to Cut Whales From Budget – for Fourth Time, Wall Street Journal, 2/14/05.

- And so forth. We don't claim to know all the excesses that are embedded in the Federal budget, but we suspect they are very substantial. Saving $200 - 300 billion per year should be readily doable, in our opinion, with no great harm to people who really need government help.

What about another way to make ends meet, <u>raising</u> <u>taxes</u>? Given the size of our country's fiscal problems, it may be necessary to accept some tax increases (if nothing else as a quid pro quo for halting the cancerous spread of the Alternative Minimum Tax), but we think this should be viewed as "the last resort." Simply put, spending cuts tend to boost the economy, while tax increases have the opposite effect.

- Let's say the cap on payroll taxes for high-earning workers (currently about $90,000 per year) was doubled. More payroll taxes would be collected, no doubt, but many of the taxpayers concerned – who happen to be some of the most productive workers in our society – would renegotiate their pay packages (more fringes, less wages). Also, the drag effect of this levy on the economy could result in an offsetting reduction of income tax revenue. When all was said and done, the net additional revenue in government coffers might disappoint us.

- Some people note that Europeans typically pay higher taxes than we do, as though this shows that the European countries are right and the United States is wrong. However, Edward Prescott, a University of Arizona economist who won the Nobel Prize for economics in 2004, credits the high tax levels in European countries for the stagnant economic growth and high unemployment levels in these countries. Why Do Americans Work So Much More Than Europeans, research paper, July 2004.

So while the president may have gone overboard on tax cuts in his first term, albeit for the purpose of reviving a sputtering economy, it does not necessarily follow that his tax cuts should be rescinded before any other action to deal with the coming financial crisis is taken. To the contrary, in our opinion, it would be better to exhaust the opportunities to cut spending first.