Social Security Endgame:
How the U.S. Can Avoid Europe's Demographic 'Black Hole'

By John D. Mueller[1]

Roundtable on Social Security and the Future of Self-Government
American Political Science Association Convention
Washington, D.C., September 1, 2005

Last November in the *Weekly Standard*, outlining the promise and pitfalls facing President George W. Bush on Social Security and income-tax reform, I described the formula for successful American fiscal policy from Abraham Lincoln's funding the Civil War to President Ronald Reagan's reforms of Social Security and the income tax. "In my experience," I said, "these principles are the key to an economic policy that is legislatively successful and politically popular. Ignore them and plausible schemes startle their proponents by erupting in political flames—as has happened with all proposals so far for a flat tax or Social Security privatization (most recently in 1996 and 1999, respectively)"[2]

Even those who (like me) voted for President Bush must concede that "erupting in political flames" aptly describes the Social Security initiative. The reason is that it proposed to violate the most basic rules of fiscal justice and economic efficiency. Yet if Pres. Bush squandered "political capital," the Democrats didn't gain any, because their approach violates the same principles. A workable compromise is fairly easy, and Chicken Littles should recall that both

---

[1] John D. Mueller is a financial-market economist in Washington, DC, and director of the Economic and Ethics program at the Ethics and Public Policy Center. From 1981 to 1988 he was Economic Council to the House Republican Conference (caucus) under Jack Kemp.

[2] John D. Mueller, "Taxes, Social Security and the Politics of Reform: A Reaganite Plan for Reagan's Heirs," *The Weekly Standard*, November 29, 2004.

Reagan's reforms were pronounced dead several times before they happened. The main danger is that the two parties "decide not to decide": find an "exit strategy," and "walk away from the table," as Fred Barnes and E.J. Dionne began urging their parties months ago. Not to decide about Social Security is to decide—to follow Europe and Japan in committing national suicide.

Politically successful fiscal policy is not rocket science. Its basic principles can be stated in a short paragraph. The most just, efficient, and popular way to pay for common goods like national defense and general government is an income tax with the broadest tax base, lowest tax rates, and most equal treatment of labor income (salaries, wages, fringe benefits) and property income (interest, dividends, rents, royalties, etc.). But the same logic dictates that more narrowly targeted benefits require narrower funding; for example, payments to persons or families (for example, Social Security retirement pensions and unemployment benefits) should be paid by taxes on labor income, and subsidies for investing in property (like tax-advantaged savings accounts) by taxing property income.

The Social Security debate is a mess because Republicans want to tax workers to subsidize property ownership, and Democrats want to tax property owners to subsidize benefits for people. Political failure begins with analytic failure. The analytical confusion of Republican ideology was reflected in Treasury Secretary John Snow's remarks to the American Academy of Actuaries May 3rd, when he said that "in 2041, the system will be exhausted, bankrupt"; and "One of the President's core beliefs on this issue is that we ought to move toward a

system that is pre-funded, that we should gradually move away from a pay-as-you-go model and give Americans the chance to save their own money. He wants to move away from the filing cabinet of IOUs and toward something that people actually own that represents real capital. Voluntary personal accounts are a step toward pre-funding the system, and that's going to put it on a more stable, guaranteed basis down the road." In other words, Secretary Snow told the actuaries that "one of the President's core beliefs" is what I have called the "economic Stork Theory": the notion that people and their skills somehow arrive from out of the blue, as if delivered by a large stork. In the Stork Theory, human capital is not "real capital," and a "pay-as-you-go" system is contrasted with one that is "pre-funded."

Consider the original pay-as-you-go system, the family. It is "pre-funded" with "real capital." As researchers depressingly inform us, the average cost of raising one child to age 17 is about $269,000, and adding college tuition and foregone income, the cost has been estimated to top $1 million.[3] Yet the average net worth of American households headed by adults of child-bearing age in 2001 was only $174,000.[4] So if property were the only form of wealth, nearly all American families with children would be exactly as Secretary Snow described

---

[3] Philip Longman, Raising Hell: How the punishing costs of child-rearing imperil us all," *The Washington Monthly*, March 1, 2004. The $269,000 figure and a survey of recent research may be found in Mark Lino, "Expenditures on Children by Families, 2004," US Department of Agriculture, Center for Nutrition Policy and Promotion, Miscellaneous Publication No. 1528-2004, 2005.

[4] Ana M. Aizcorbe et al, "Recent Changes in U.S. Family Finances: Evidence from the 1998 and 2001 Survey of Consumer Finances," *Federal Reserve Bulletin*, January 2003, 1-32; figures based on tables 1 & 3. Average net worth was $396,000; median net worth, $86,000. The age range used to calculate the Total Fertility Rate is 15-44 years.

Social Security—"bankrupt"—since the present value of their prospective liabilities far exceeds the total value of their property. Fortunately, nearly all couples of child-bearing age do possess the necessary "real capital" in the form of their own economically valuable skills. They can't legally sell it (because of the 13th Amendment), or pawn it (because of state laws against indentured servitude). But what all parents do, in effect, is pledge their human wealth against the costs of raising their children.

The Social Security retirement system was serendipitously[5] designed to work essentially the same way. Its popularity stems from the fact that a pay-as-you-go retirement pension is a form of saving that private markets cannot (legally) provide. The assets backing Social Security retirement pensions comprise neither the fabled "Trust Fund," nor the "full faith and credit of the United States," but rather the fraction of the "human capital" of American workers approximating the payroll tax rate (currently about one-eighth[6]). By pooling this fraction of their labor income, workers can transfer income from working in the labor market to themselves after retirement and to their spouses and dependents after their deaths. According to Secretary Snow, this is what President Bush wants to "move away from." To judge by the President's sharp drop in the polls

---

[5] The structure of benefits, including the key spousal benefit, was designed by the remarkable group of anti-feminist women led by Frances Perkins that Allan Carlson has called the "American Maternalists": Allan Carlson, "Sanctifying the Traditional Family': The New Deal and National Solidarity," *The Family in America* Vol. 16 No. 5, May 2002, 1-12, (later a chapter in Carlson's '*The American Way': Family and Community in the Shaping of American Identity*, ISI Books, 2003). But Franklin Delano Roosevelt accepted the principle that benefits always remain self-financing with workers' payroll contributions originated at the insistence of Treasury Secretary Henry Morgenthau over the "maternalists'" objections: David M. Kennedy, *Freedom From Fear: The American People in Depression and War, 1929-1945*, Oxford History of the United States

precisely during his 60-day campaign, that message came across loud and clear.

Social Security's problems are not due to the *structure* of benefits but their prospective size, and to the fact that the system is *not* pay-as-you-go. Since 1990 the system has collected far more from workers in payroll taxes than necessary to pay current benefits; and within a few years, annual benefits are expected to exceed payroll tax revenues at today's rate. According to former Republican actuary Robert Myers, this resulted inadvertently from the 1983 Social Security commission's narrow focus on the 75-year balance of income, failing to pay enough attention to the year-by-year balances.[7] Around 1990, Myers and Sen. Daniel Patrick Moynihan tried to get Congress to cure these imbalances, but were rebuffed by Democrats and Republicans who had grown to like funding general government with surplus payroll taxes (thus permitting higher Federal spending for Democratic constituents and lower taxes on Republican constituents than would otherwise have been possible.

While the Republican Party's ideology is reflected in the Stork Theory, the Democratic Party's ideology is expressed in its Ostrich Theory: If we don't look at the problem, it will go away. According to this view we have many leisurely decades to solve the problems of Social Security (and Medicare and Medicaid, which are even larger[8]), and we can adopt the same policies and lifestyles as in Europe without the same result. The motive behind the Ostrich Theory, like the

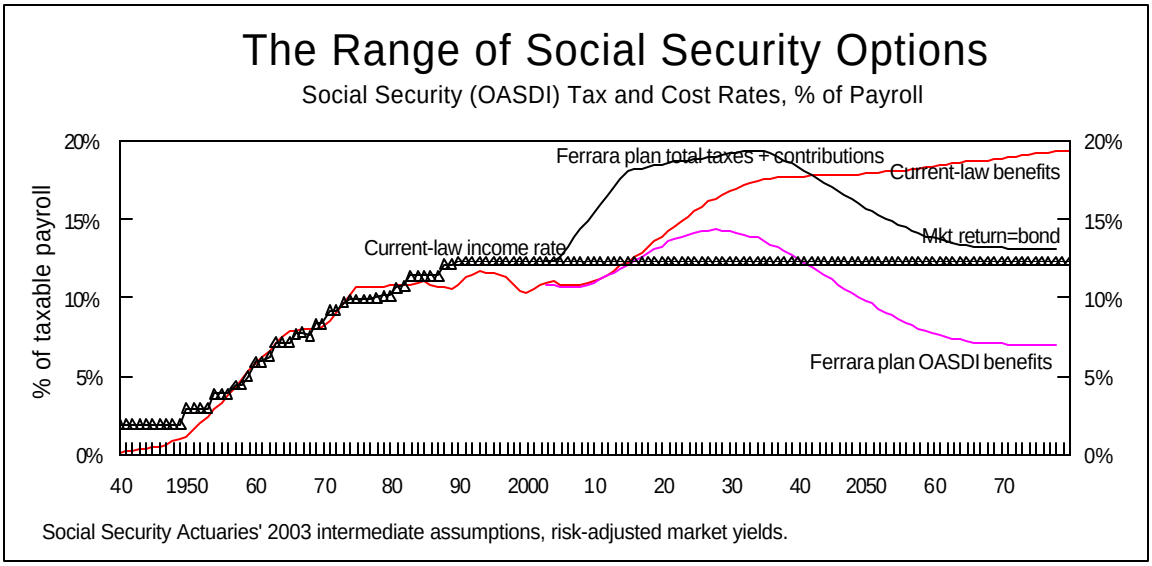
---

Vol. IX, Oxford University Press, 1999, 268-270.

[6] The Old Age, Survivors and Disability Insurance (OASDI) tax rate is now 12.4%.

[7] Myers was at Social Security from Day One, served as chief actuary from 1947 to 1970 and as executive director of the Greenspan Commission. His fascinating oral history can be found at http://www.ssa.gov/history/myersorl.html.

Stork Theory, is to shift the cost of government to the other party's constituents. Just as Republicans want to tax workers to subsidize property ownership, Democrats want to tax property owners to subsidize workers. Democrats propose to allow Social Security benefits to rise as a share of national income and pay for them by raising taxes on personal property income, corporate profits, and estates.



Unfortunately, we don't have the luxury of waiting decades. As a chorus of analysts across the political spectrum—Phillip Longman, Robert Samuelson, Nicholas Eberstadt, George Weigel, Allan Carlson—agrees, the United States is teetering on the brink of exactly the same demographic black hole that has already started to swallow Europe and Japan. Like successful fiscal policy, the

[8] See attached charts below of the Congressional Budget Office's forecast through 2075.

formula for national suicide is simple: First, legalize abortion[9]. Second, when foreigners line up to fill the demographic vacuum, shut off immigration.[10] Third, when the fiscal system totters on its shrinking demographic base, shift the burden to couples of child-bearing age. The "lockboxes" now proposed by both liberal Democrats and libertarian Republicans are childproof.

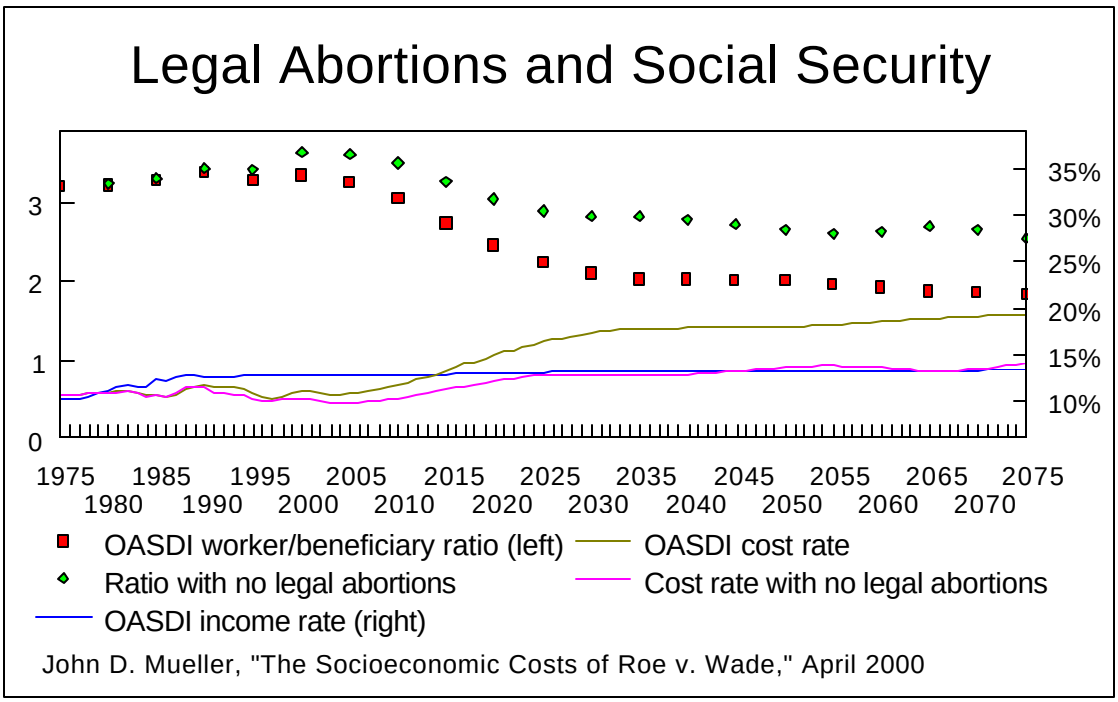
The unpleasant fact for liberal Democrats is that you can have *either* a balanced pay-as-you-go Social Security system *or* legal abortion—but not both. As I showed five years ago, if abortion had not been legalized, the Social Security system would not only have a larger surplus today, but also would have stayed in balance indefinitely at today's tax rates[11].

---

[9] Japan legalized abortion in 1948, 25 years before the United States, ending its postwar baby boom: the largest cohort today was born in 1948. Europe now ends over half its known pregnancies by abortion, vs. one-quarter in the Untied States.

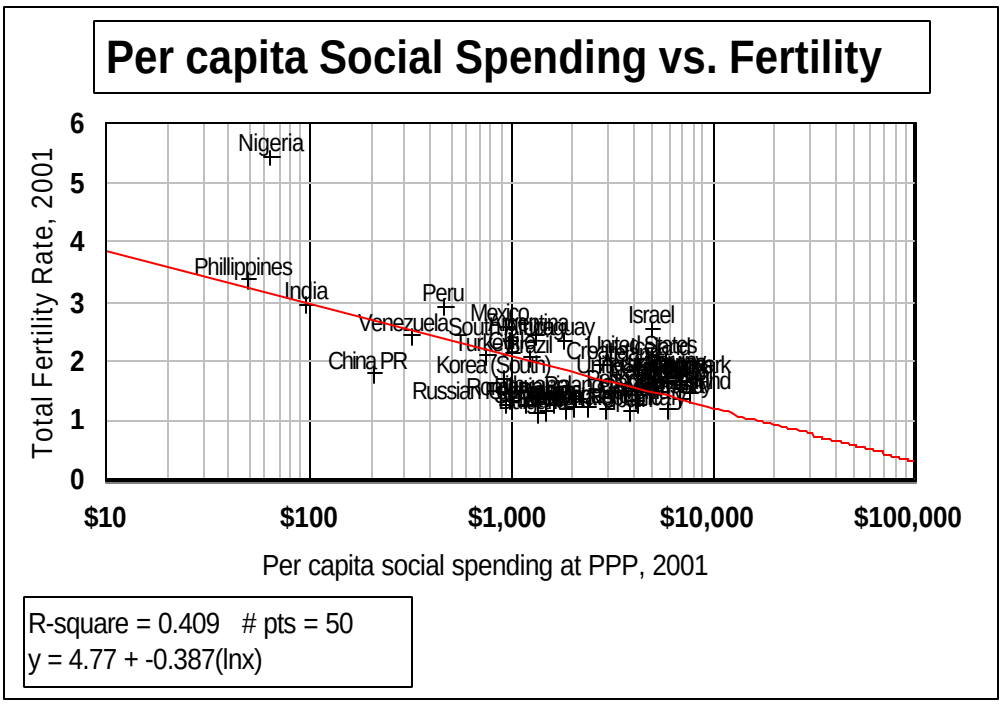
[10] The annual number of legal and illegal immigrants to the United States—between 1 and 1-1/2 million—is almost exactly equal to the number of abortions 20 to 25 years earlier.

[11] John D. Mueller, "The Socioeconomic Costs of Roe v. Wade," *Family Policy*, Vol. 13 No. 2, March-April 2000.



But while fertility affects Social Security, Social Security also affects fertility. The second unpleasant fact for liberals, as I show in a forthcoming study[12], is that fertility is inversely related to social welfare benefits. This is because such benefits are an economic substitute for having children.

[12] John D. Mueller, "How Does Fiscal Policy Affect the American Worker?" *Notre Dame Journal of Ethics, Law and Public Policy* (forthcoming) from which the charts on fertility are drawn.

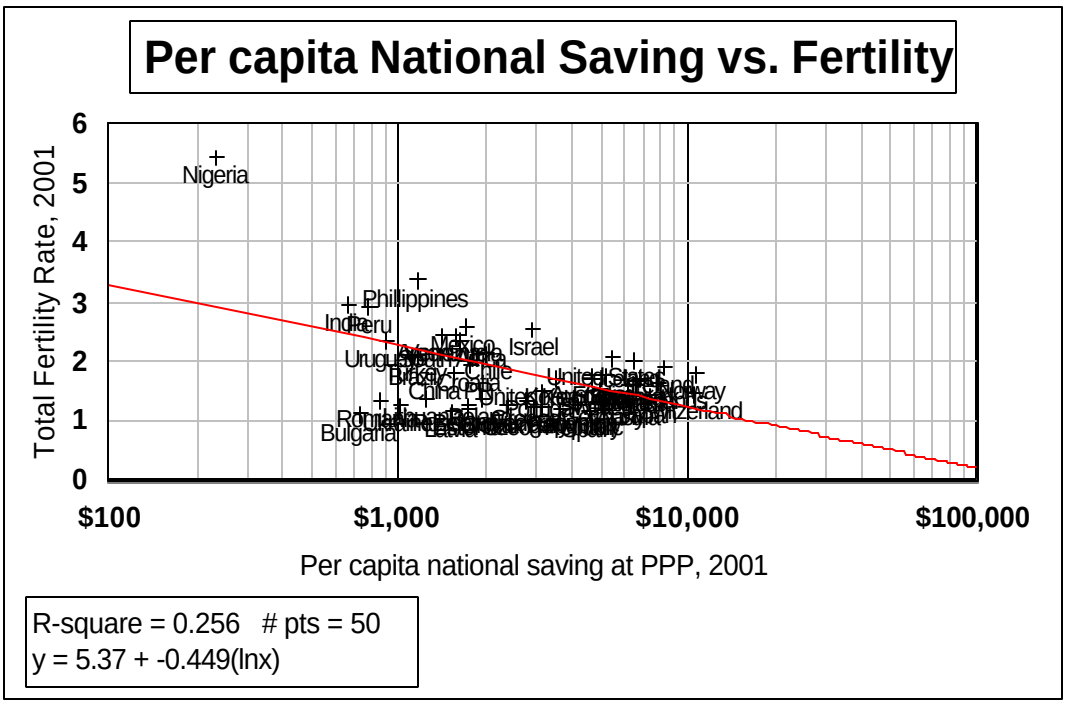


But the equally unpleasant fact for Republicans is that extracting increased saving from American families with a consumption tax or compulsory[13] retirement accounts has exactly the same demographic result—because stocks and bonds are also, in effect, economic substitutes for children.[14]

---

[13] The accounts are compulsory if parents are not free to use the money to raise children, and those who forego private accounts have to pay taxes to fund everyone else's. This is true of all Republican proposals so far.

[14] This is also the conclusion of Michele Boldrin, Mariacristina De Nardi and Larry E. Jones, "Fertility and Social Security," Working Paper 11146, http://www.nber.org/papers/w11146, National Bureau of Economic Research, Cambridge, MA, February 2005. See also John D. Mueller, "Social Security and Fertility: Comment on Allan Carlson's paper," Family Research Council panel on "Making Social Security Family-Friendly," February 23, 2005, http://www.eppc.org/publications/pubID.2270/pub_detail.asp.

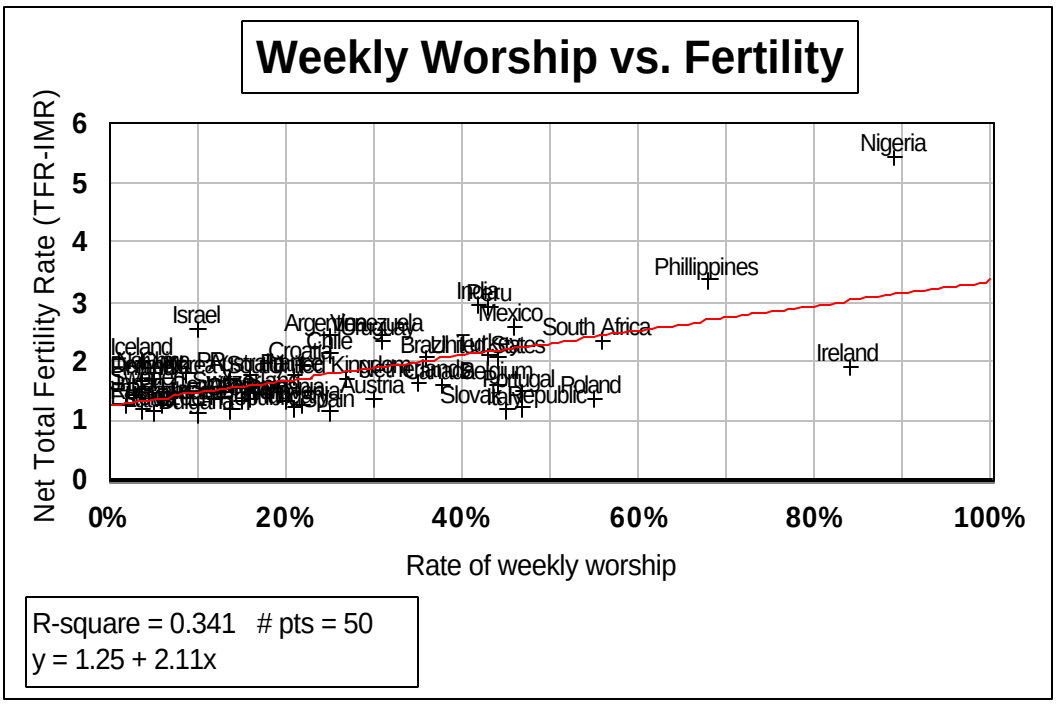


Yet as George Weigel has argued[15], allowing for fiscal policy and national saving, we are dealing with a fundamentally spiritual problem. The study I have already mentioned shows that when people whose horizons are confined to this world have ample sources of wealth other than children, they simply don't reproduce themselves.[16]

---

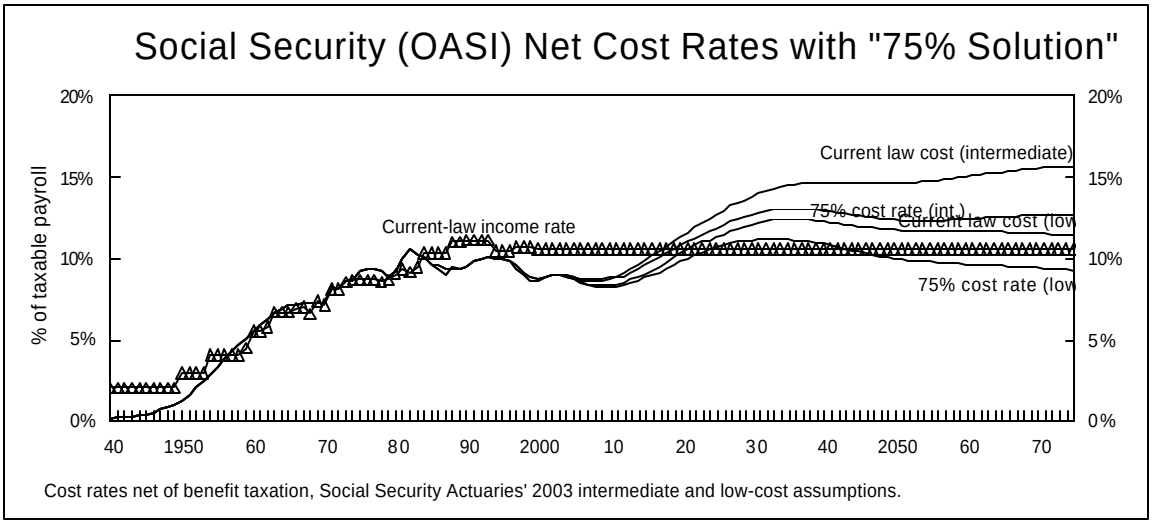
[15] George Weigel, *The Cube and The Cathedral,: Europe, America and Politics Without God*, Basic Books, 2005.

[16] My forthcoming study in the *Notre Dame Journal of Law, Ethics and Public Policy*, already noted, explains that the inability of existing models of fertility to match actually observed Total Fertility Rates (notably including the United States) is the result of their failure to account for differing religious behavior, which is systematically connected with fertility. Both express people's most basic preferences for devoting scarce resources (time and wealth) to persons in addition to themselves. When frequency of worship is included along with per capita social benefits and national saving, the resulting model of fertility explains the U.S. fertility rate exactly, and most of the variation among the 50 countries for which data are available, comprising about two-thirds of the world's population. Predicted vs. actual fertility is shown in a chart below.



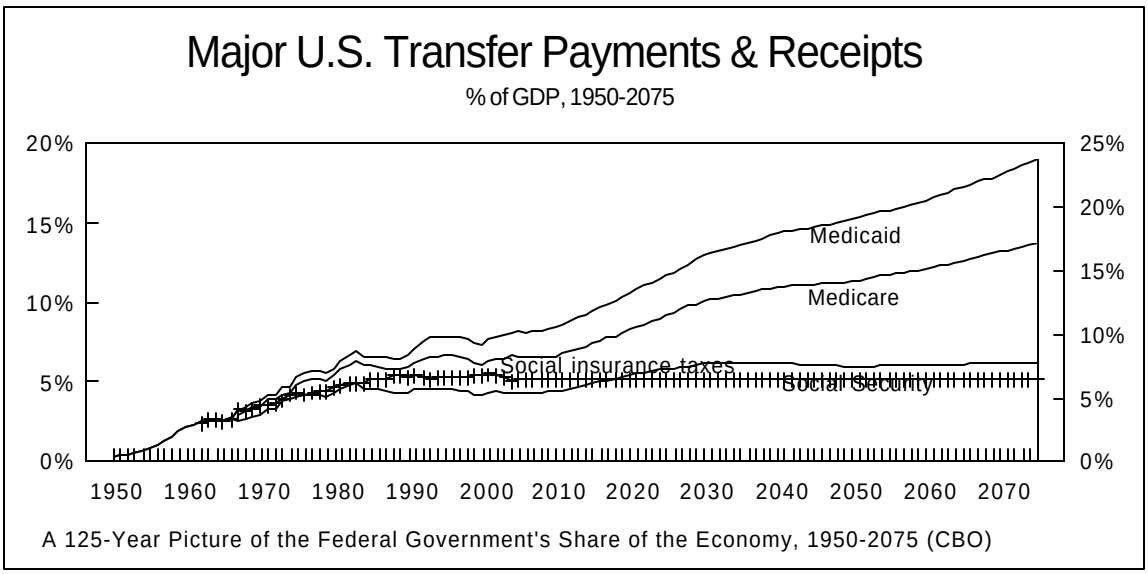
The outline of an economically and politically workable solution is simple. If Republicans want to bribe workers to acquire financial assets (and thus become Republicans), the bribe must be paid with taxes on property or property income—for example, dedicating the estate tax or the tax on dividends, both of which the Republicans want to abolish. And if Democrats want to save Social Security, all benefits must be paid with payroll taxes, without raising taxes on future workers. I proposed such a plan in 1995 to the National Commission on Economic Growth and Tax Reform, cutting payroll taxes immediately (getting rid of the surplus) and reducing future retirement benefits in the same proportion, preventing both future deficits and tax hikes without lowering the rate of return.[17]

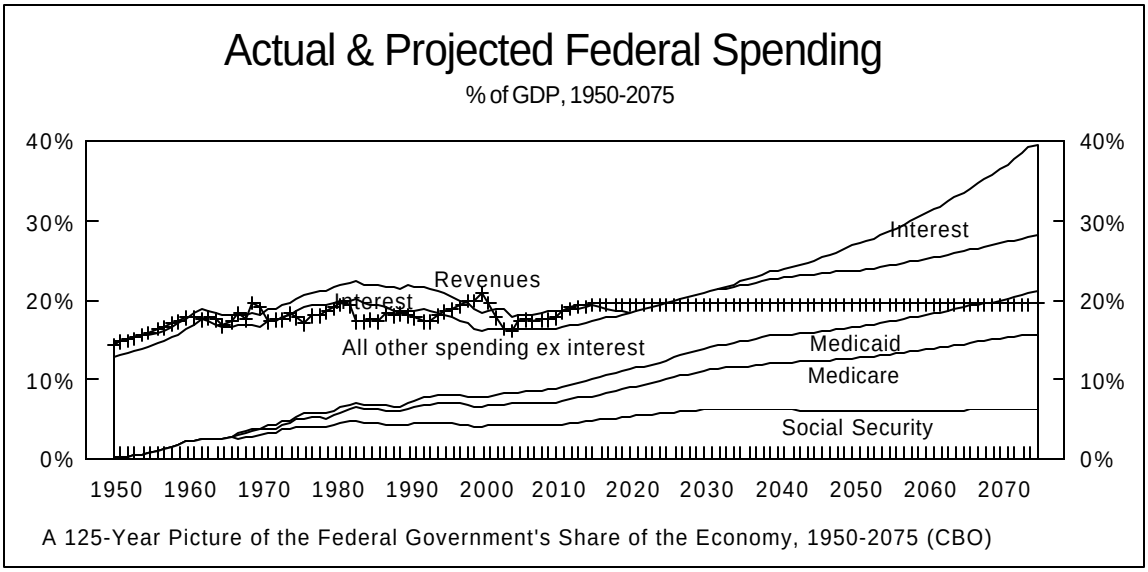
[17] Described in the Weekly Standard article and at http://www.eppc.org/programs/economics.

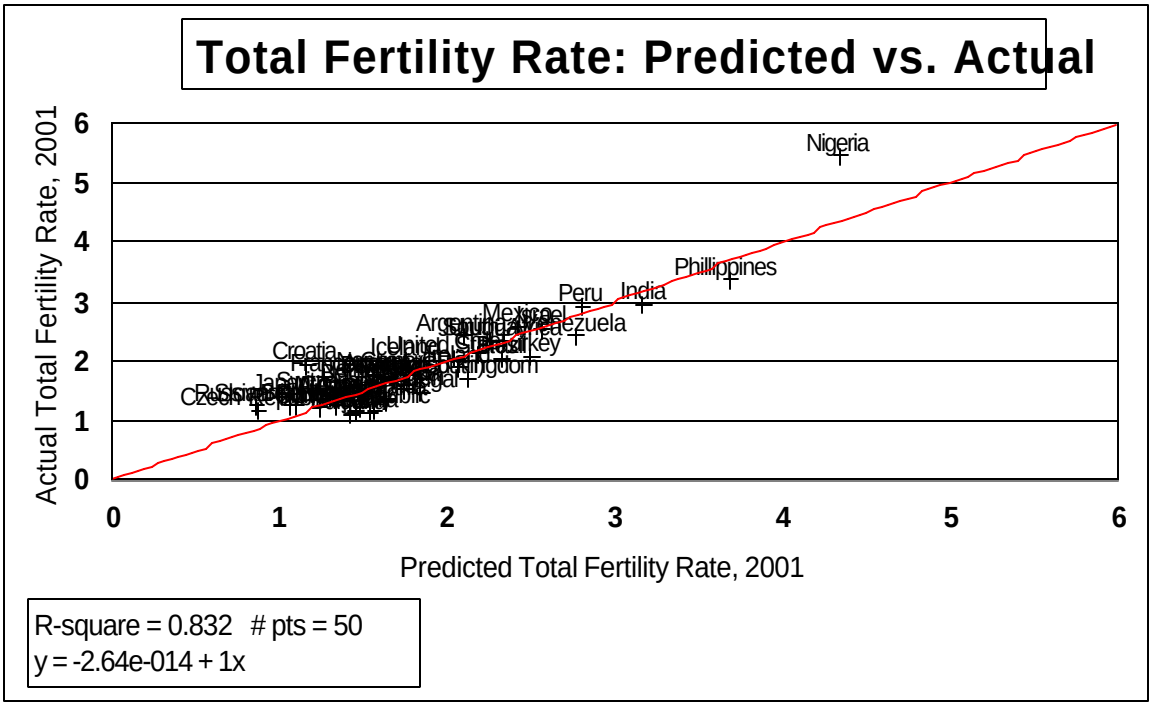


Instead of a Total Fertility Rate somewhere between the "Intermediate" and "High-Cost" assumptions, I calculate that the result would be between the intermediate and low-cost assumptions. To balance the non-Social Security budget, I recommended a single tax rate on all labor and property income, except for a credit based on family size. This would solve the fiscal and fertility problems simultaneously and equitably.

So while we must listen politely to the Chicken Littles, the Stork and Ostrich Theorists, we can and must refuse their advice to follow Europe and Japan like lemmings. I join those analysts I have mentioned in saying to our fellow Americans, as Moses told his fellow Israelites: "*This day I call heaven and earth as witnesses against you that I have set before you life and death, blessings and curses. Now choose life, so that you and your children may live." (Dt. 3:19)*


Major U.S. Transfer Payments & Receipts
% of GDP, 1950-2075
20%
15%
10%
5%
0%
25%
20%
15%
10%
5%
0%
Medicaid
Medicare
Social insurance taxes
Social Security
1950 1960 1970 1980 1990 2000 2010 2020 2030 2040 2050 2060 2070
A 125-Year Picture of the Federal Government's Share of the Economy, 1950-2075 (CBO)


Actual & Projected Federal Spending
% of GDP, 1950-2075
40%
30%
20%
10%
0%
40%
30%
20%
10%
0%
Interest
Revenues
Interest
All other spending ex interest
Medicaid
Medicare
Social Security
1950 1960 1970 1980 1990 2000 2010 2020 2030 2040 2050 2060 2070
A 125-Year Picture of the Federal Government's Share of the Economy, 1950-2075 (CBO)



Year	Actual Total Fertility Rate (TFR) and model with projected social benefits	SSA Trustees Intermediate Assumptions TFR	SSA Low-Cost TFR	SSA High-Cost TFR
2001	2.05	--	--	--
2025	1.98	1.95	2.18	1.74
2050	1.92	1.95	2.20	1.70
2075	1.87	1.95	2.20	1.70