

From: Wehner, Peter H.

[mailto:Peter\_H.\_Wehner@who.eop.gov] Sent: Monday, January 03, 2005 2:57 PM Subject: Some Thoughts on Social Security I wanted to provide to you our latest thinking (not for attribution) on Social Security reform.

I don't need to tell you that this will be one of the most important conservative undertakings of modern times. If we succeed in reforming Social Security, it will rank as one of the most significant conservative governing achievements ever. The scope and scale of this endeavor are hard to overestimate.

Let me tell you first what our plans are in terms of sequencing and political strategy. We will focus on Social Security immediately in this new year. Our strategy will probably include speeches early this month to establish an important premise: the current system is heading for an iceberg. The notion that younger workers will receive anything like the benefits they have been promised is fiction, unless significant reforms are undertaken. We need to establish in the public mind a key fiscal fact: right now we are on an unsustainable course. That reality needs to be seared into the public consciousness; it is the pre-condition to authentic reform.

Given that, our aim is to introduce market reforms in Social Security and make the system permanently solvent and sustainable.

We intend to pursue the first goal by using our will and energy

toward the creation of Personal Retirement Accounts. As you know, our advocacy for personal accounts is tied to our commitment to an Ownership Society -- one in which more people will own their health care plans and have the confidence of owning a piece of their retirement. Our goal is to provide a path to greater opportunity, more freedom, and more control for individuals over their own lives. That is what the personal account debate is fundamentally about -- and it is clearly the crucial new conservative idea in the history of the Social Security debate.

Second, we're going to take a very close look at changing the way benefits are calculated. As you probably know, under current law benefits are calculated by a "wage index" -- but because wages grow faster than inflation, so do Social Security benefits. If we don't address this aspect of the current system, we'll face serious economic risks.

It's worth noting that wage indexation was not part of the original design of Social Security. The current method of wage indexation was created in 1977, under (you guessed it) the Carter Administration. Wage indexation makes it impossible to "grow our way" out of the Social Security problem. If the economy grows faster and wages rise, this produces more tax revenue. But the faster wage growth also means that we owe more in Social Security benefits. This has produced a never-ending cycle of higher tax burdens, even during periods of robust economic growth. It is the classic case of the dog chasing his tail around the tree; he can run faster and faster, and never make any progress.

You may know that there is a small number of conservatives who prefer to push only for investment accounts and make no

effort to adjust benefits -- therefore making no effort to address this fundamental structural problem. In my judgment, that's a bad idea. We simply cannot solve the Social Security problem with Personal Retirement Accounts alone. If the goal is permanent solvency and sustainability -- as we believe it should be -- then Personal Retirements Accounts, for all their virtues, are insufficient to that task. And playing "kick the can" is simply not the credo of this President. He wants to do what needs to be done for genuine repair of Social Security.

If we duck our duty, it can have serious short-term economic consequences. Here's why. If we borrow \$1-2 trillion to cover transition costs for personal savings accounts and make no changes to wage indexing, we will have borrowed trillions and will still confront more than \$10 trillion in unfunded liabilities. This could easily cause an economic chain-reaction: the markets go south, interest rates go up, and the economy stalls out. To ignore the structural fiscal issues -- to wholly ignore the matter of the current system's benefit formula -- would be irresponsible.

Here's a startling fact: under current law, an average retiree in 2050 would be scheduled to receive close to 40 percent more (in real terms) in benefits than an average retiree today -- and yet there are no mechanisms in place to produce the revenue to pay out those benefits. No one on this planet can tell you why a 25-year-old person today is entitled to a 40 percent increase in Social Security benefits (in real terms) compared to what a person retiring today receives.

To meet those benefit levels, one option would be to raise the age at which people receive benefits. If we followed the formula used when Social Security was first created -- make

the age at which you receive Social Security benefits above the average age of mortality -- we'd be looking at raising the benefit age to around 80. That ain't gonna happen.

Another way to meet those benefit levels is through the traditional Democrat/liberal way: higher taxation. According to the latest report of the Social Security Trustees, the current system's benefit formula would require some \$10 trillion in tax increases over the long term. We'd therefore need to raise the payroll tax almost 20 percent simply to provide wage-indexed benefit levels to those born this year.

This will all sound familiar. In the past, the way Congress usually addressed the built-in funding problem was by raising payroll taxes (from 2 percent in 1937 to 12.4 percent today). In fact, Congress has raised Social Security taxes more than 30 times -- but it has never addressed the underlying problem. Avoiding the core issue by raising taxes is not the modus operandi of this President.

The other key point, as you know, is that personal accounts, through the miracle of compound interest, will provide workers with higher retirement benefits than they are currently receiving from Social Security.

At the end of the day, we want to promote both an ownership society and advance the idea of limited government. It seems to me our plan will do so; the plan of some others won't.

Let me add one other important point: we consider our Social Security reform not simply an economic challenge, but a moral goal and a moral good. We have a responsibility to fulfill the promise of Social Security, not undermine it. And we have a duty to ensure that we do not create an inter-generational

conflict -- which is precisely what will happen if the Social Security system is not reformed. We need to retain strong ties between the generations, which is of course a deeply conservative belief.

The debate about Social Security is going to be a monumental clash of ideas -- and it's important for the conservative movement that we win both the battle of ideas and the legislation that will give those ideas life. The Democrat Party leadership, the AARP, and many others will go after Social Security reform hammer and tongs. See today's silly New York Times editorial (its only one for the day) as one example. But Democrats and liberals are in a precarious position; they are attempting to block reform to a system that almost every serious-minded person concedes needs it. They are in a position of arguing against modernizing a system created almost four generations ago. Increasingly the Democrat Party is the party of obstruction and opposition. It is the Party of the Past.

For the first time in six decades, the Social Security battle is one we can win -- and in doing so, we can help transform the political and philosophical landscape of the country. We have it within our grasp to move away from dependency on government and toward giving greater power and responsibility to individuals.

There are of course other important issues dealing with Social Security; for now, though, I've covered quite enough ground. I wanted to let you know where things stand. If you have any questions, or if we can send you anything to clarify our plans and respond to critics, just let me know. The President remains flexible on tactics -- and rock-solid on the principles.

But there's nothing new there.

In one of his last public acts of an extraordinary public life, the late Democratic Senator from New York, Daniel Patrick Moynihan, co-chaired the President's Commission to Strengthen Social Security. In the introduction of its report, Senator Moynihan (along with Richard Parsons, his co-chair) wrote, "the time to include personal accounts in such action [reforming Social Security] has, indeed, arrived. The details of such accounts are negotiable, but their need is clear.... Carpe diem!"

And so we shall.