Social Security: The Coming Crash
Peter G. Peterson

Social Security’s troubles are fundamentally its financial problems and not minor administrative inefficiencies, as some politicians, at least in election years, feel compelled to insist. Unless the system is reorganized, there is little chance that it can survive without fundamental reform. To put the matter bluntly, Social Security is heading for a crash. We cannot patch this hole to 1982, 1983, and 1984, and put the nation itself in very serious jeopardy. Though in effect for only two generations, Social Security has become the defining link between citizen and state in modern America. It has such universal and essential appeal that any talk that the system crashes, to almost certainly will shatter the social harmony and the emotional well-being of the private Social Security and for general prosperity are now inseparable.

The Social Security system has become a high-risk gamble on economic progress and population growth—a bet by today’s taxpayers that their children and grandchildren will be rich and numerous enough to foot the bill for another round of generous retirement benefits. Should this hope go even mildly awry, today’s workers will retire into a Social Security system with deficits larger than the total benefits it pays out today.

Meanwhile, the system—which spent over $100 billion in fiscal 1982—has already grown so colossal as to shape the entire future of the economy. Social Security spending has moved from 9 percent of the total federal budget in 1950 to 26 percent today. By far the biggest government social program in a world history, the system now sprawls each year more than the combined net investment, consumption, research, and development of all the private companies in the United States.

During the last few years, we have witnessed a revolt against both the burden of rising federal taxes and the binge of spending that has made the deficits necessary. In many ways, Social Security is the prime mover of both. A little over a decade ago, inflationary pressures between 1953 and 1959 Social Security taxes more than accounted for the increase in the inflationary pressures of the GNP. The growth in Social Security outlays is responsible for almost all of the increase in inflationary pressures of the GNP. Consequently, if Social Security spending were cut, both inflation and unemployment would have declined and federal outlays would have remained virtually unchanged.

There are good reasons to trust the Social Security puzzle than economics. It raises questions of ethics as well. Is a "con- tract" a contract that requires it to give today’s older people a vastly higher return on their contributed taxes than children and grandchildren can possibly hope to receive? Is it a welfare program that gives almost 20 percent of its tax-free benefits to the 20 percent of the elderly population with highest incomes what we want? (Incidentally, that 20 percent of the elderly living’s average family income of $10,000 a year or more, and those over sixty-five who are married to non-working spouses can expect to receive social security benefits that will total about fifty times their lifetime payroll tax contributions.)

If Social Security’s financial problems cause the entire economy to fall into perpetual stagnation, robbing our children and grandchildren during their working and retirement years of their rudimentary economic security and, indeed, of every other Social Security, such ethical dilemmas of the Social Security system will become inevitable. One of the highest moral obligations facing us is to give our offspring a decent chance at prosperity. If we fail there, the Social Security system itself, and much else, will disappear.

1. The US economy is suffering from a progressive disease—a spreading paralysis of those activities that raise the standard of living. I am not referring to the current recession. In discussing Social Security and our economy, we should try to think of decades and generations. Americans, ever impatient, are inclined to mistake short-term cycles for long-term trends. But the economy’s worst problem is not in fact today’s high unemployment or yesterday’s soaring inflation. Rather, it is described in the following comparison:

Annual Productivity Growth Rate
1948-1957 2.5% 1967-1972 1.6%
1972-1981 0.1%

As these figures show, America’s machinery for creating national wealth is slowing down. The ability of our workers to produce more each year is becoming weaker each year. This slump in the growth of productivity now has little visible effect on daily life. But the cumulative impact will be enormous. If we consider the year 2020, when those now in their 20s will be at their working prime, if productivity stays roughly the same—or at even the recent past 2.5% times (but does not get worse)—the average worker in 2020 will produce only $22,800 in goods and services, just about what he does today. The country, for the first time in its history, will have stood still for a span of forty years. (By contrast, the last forty years it has seen real income produced per worker rise from $10,000 to $22,000, or about 120 percent.

Further, if the other hand, productivity were now to start growing again at the 2.5 percent rate which prevailed from 1948 to 1967, the average worker in 2020 would produce $57,700 in goods and services, an increase of about 160 percent. In that case, our grandchildren would look back on us as relative paupers, and would by 2020 be enjoying a buoyant prosperity and widening social opportunities in a nation that was a strong force in the world’s economic and political affairs. But we are instead on a course leading to unprecedented stagnation, almost ceremal social strife, and steadily diminishing international influence.

Why are we heading toward the worst future? Many managerial and cultural factors are responsible, and their relative importance remains a matter of dispute. But one factor seems prominent in virtually every study that has been made: the productivity of US workers is stagnating largely because they are not being provided with an adequate flow of new tools—new plant and equipment, innovative techniques, improved methods of production—and new products.

New tools and ideas are provided by investment—by adding to the stock of capital, physical and intellectual, that will generate income in the future. We have been underinvesting in the future. A comparison with Japan during the Seventies is instructive, and sobering:

—Japan invested nearly three times as much in new corporate plant and equipment (9.8 percent of GDP vs. 3.4 percent in the US).
—Japanese invested over seven times as much in public "infrastructure" such as roads and waterways (5.0 percent vs. 0.7 percent).
—Japan invested 20 percent more in civilian research and development, education, and defense and safety (1.9 percent vs. 1.6 percent).

The differences between Japanese investment in scientific, technical, and safety fields and the US are huge, if not as precisely measurable.

Investment requires savings. One reason we are investing too little is that we are using up every year, in current and often capital consumption, far too much of the income we are producing. The national pool of savings available for investment is only $1 billion. This is because the flow of personal and business savings into the pool has been insufficient. Compared to that of other industrialized countries, savings from individuals and families in the US have been a mere trickle. Between 1970 and 1979, for instance, the household sector of the economy saved on average only five cents of each dollar earned. The comparable figure for Japan was about fifteen cents of each dollar earned.

The chief explanation for this difference is very straightforward. The Japanese have consciously designed their economic incentives to reward savings and investment. We have largely rewarded borrowing and consumption. For example, no other major industrial country permits unlimited tax deductions for interest. In Japan, moreover, personal income derived from capital—i.e., from savings—is taxed either lightly or not at all. That the US, such "unearned income" suffered especially high taxes until recently, and still enjoys at that rate of about 55 cents in each dollar earned.

In Japan, buying houses and durable consumer goods on credit is difficult and expensive. In America, the tax and the banking system are heavily skewed toward financial promotion—playing a large role in the saving at the lowest possible level.

Pensions in Japan—both public and private—are theoretically targeted to save for their retirement. Social Security in America now seeks to provide every eligible retired person, regardless of income, with a guaranteed income.
need, with a stipend sufficient to cover all or at least most of the basic necessities of life. The result is likely to be accordingly weakened. As for American corporations, while their flow of savings (so-called “earnings”) has traditionally been considerable, a sus-
tained binge of corporate borrowing has been dangerously exacerbated.

We have thus become a nation of spendthrifts and Japan a nation of savers. But it is an illusion to think that we could quickly and simply change our laws, institutions, habits, and culture so that they will more closely resemble those of Japan. The recent changes in the tax structure to encourage more saving by households and businesses will prove helpful, but further changes in the tax system, through no fault of the government, will require a long and hard effort, and the amount of additional savings they might provide remains uncertain.

2.

Of necessity, we must turn to a surer and more direct strategy for enlarging the pool of savings available for investment: namely, to stop the government from borrowing from the social security fund. The government finances its deficits by using up—literally extinguishing—the savings generated by the country’s citizens and corporations. This government “dis-
saving” has taken on new and frightening dimensions over the past several years and the problem is likely to get worse. The recent rhetoric about the evils of deficit spending and the debate over the balanced-budget amendment have partly hidden a distressing reality. The U.S. now faces federal deficits so large, so long-
term, and so unprecedented that if or when an economic recession occurs our shrinking pool of savings would be sub-
stantially depleted. There would be little left to sustain the levels of investment we need to restore economic growth and international competitive-
ness. In view of widely publicized efforts of the Reagan administration to reduce federal deficits, it is ironic that:

Some facts on debt-heavy corporate balance sheets are set forth with admira-

Estimated Federal Government Outlays, Comparison of 1980 to 1985 as Now Projected

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<th>In Dollars of Millions</th>
<th>In Share of GNP³</th>
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<td>National Defense</td>
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<td>Non-related Social Security (Federal Pensions, etc.)</td>
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<td>Grants to State and Local Governments</td>
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at 3 to 4 percent per year. Rising deficits during a prolonged economic recovery are not unprecedented in this country. Of course, the financial imbalances that would result from such large deficits call into question whether the economy would in fact sustain 3 to 4 percent growth for the next few years. If the economy is instead flat, the deficits would be much larger.

Thus we have created a fiscal Frankenstein monster. If and when a strong recovery occurs, this monster would be accused of devouring immense amounts of available savings. One can question whether a normal cyclical recovery from the current recession can occur in the face of this monster. What clearly cannot occur is the necessary revival of investment needed to produce future years' output and employment. Simple arithmetic alone makes it obvious that only a few parts of the budget are, by themselves, large enough to yield the kinds of savings that will be required. I would also hope that a sense of simple equity would not lead us to put the "need-related" programs for the poor into the axe once again. Most federal operations are also unlikely
to do this.
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