Fiscal Policy Institute

275 Seventh Ave, 6th floor
New York, New York 10001
madler@uniteunion.org
Tel: 212 414 9308
Fax: 212 414 9002

Economic Growth Will Not Save the Social Security System

by
Moshe Adler
Senior Economist

Statement Submitted to the President's Commission to Strengthen Social Security

As Commission member Professor Thomas Saving has explained in several newspaper articles, all the proposals to address the problem that the social security system faces are based on the assumption that this problem can be fixed through economic growth. Without more goods and services to go around an increasing ratio of retirees to workers must inevitably mean fewer goods for workers, for retirees or for both. But economic growth cannot in fact solve the problem, because growth does not actually increase the economic pie, it mainly changes it. Economic growth does not result in more of the same goods, but rather a different mix of better and new goods.

The digital camera is a good means of understanding what growth is and whether it can correctly be described as increasing the quantity of goods. There is little doubt that over time digital cameras will become so much more useful than film cameras that as some point they'll render existing film cameras obsolete. They will also make existing computers that are not powerful enough to handle digital images and existing printers that are not picture-quality obsolete. But first they will all have to be produced. And in order to produce them capital and labor will have to be diverted from the production of other goods. Some of the capital and labor may be diverted from the shrinking film camera industry, but since most consumers already have film cameras, this industry is smaller than the digital camera industry with its many peripherals will be. Other industries will also have to be tapped, perhaps even industries that currently cater directly to retirees. Thus growth does not free labor and capital, it consumes them. And although it may provide people with new possessions it also makes some of their existing possessions obsolete.

So how can the introduction of the digital camera count as growth? It counts as growth first of all because growth is measured in dollars. If the dollar value of the new cameras and the peripherals that they require exceeds the dollar value of the goods that they displace, by definition growth has occurred. (Because investors invest to increase value, investment normally results in growth). It is not necessarily wrong to count the introduction of the digital camera as growth: its benefits are great. But how can their introduction be described as "a greater quantity of goods"?

It's not just that there aren't more goods. If retirement checks are not linked to growth, retirees will have less. A retiree who started her retirement in the film camera age but lives through the transition to the digital camera will discover that her retirement check permits her to continue buying film, but not the digital camera she needs along with its necessary peripherals.

Investments in industrialized economies are rarely if ever intended to close the gap between consumers' existing needs and the inventory of existing goods. What investors want is to widen the gap between needs that consumers may not yet have and the supply of goods which do not yet exist. And the evidence of their success is everywhere. Inflation adjusted retirement benefits permit a retiree to consume each year the same goods that she consumed the year before. But in a growing economy this is not only not what consumers want, it is often not even possible. As the pie becomes better consumers--including retirees--develop a taste for the new recipe.

Thus, unless the level of social security's real benefits grows at the same rate as the economy, retirees will have to choose between the same-size basket of the goods that growth will have rendered stale and a smaller basket of the new goods. The only way that growth can "save" the social security system is by making retirees poorer. This is true regardless of whether social security taxes are privatized or the system remains as is.

Given that change is the nature of economic growth, one equitable way to divide the burden of retirement between workers and retirees would be to tie retiree benefits not to the cost of living but to the median wage in the economy. My calculations show that that would mean that when the ratio of workers to retirees reaches its lowest projected level of 2 to 1, social security taxes will have to rise to 17% from the current level of 12%.

If the increase in the burden or retirement is unavoidable, the question of how to divide this burden between retirees and works becomes one of equity rather than expertise. As such, all Americans should participate in the debate about how to divide the increasing burden of retirement between retirees and workers. The assertion that growth can make the problem of changing demographics go away is simply false.

These issues are discussed at greater length in: Moshe Adler, "Can Economic Growth Save Social Security," *Challenge* September-October 2001. Copies will be supplied upon request.