COMMENTARY

Shlaes: Can we afford Social Security?

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Older Americans tend to think of Social Security as something we ought to be able to afford. Indeed, many seniors tell themselves that when Washington pours extra cash into the New Deal pension program, the action is something like investing in a new Volvo. The purchase may look extravagant but is, in reality, deliciously necessary. This attitude is also held by some of our most respected pension officials. The longtime Social Security Administration commissioner Robert M. Ball wrote on The Washington Post op-ed page last month that "it's the essence of responsibility, in my view, to insist on no benefit cuts."

Ball is partially right. American retirees can have a Volvo. There is a way to keep Social Security with no benefit cuts. It is the upgrade that's the problem. There is no way the country can afford a newer model for each new cohort of retirees. Not when the economy grows at a rate of 1 percent or 2 percent or 3.9 percent — the rate it expanded in the third quarter this year. The reasons for this trace not as much to the New Deal as to postwar authorities, including Ball.

Franklin Roosevelt explicitly limited Social Security's commitment, saying in August 1935 that the goal of the new program was not a total pension but "some measure of protection to the average citizen and to his family." I.S.C. 9, the legendary pamphlet that laid out the program, delineated a ceiling on Social Security payments through the decades. "You and your employer will each pay three cents on each dollar you earn, up to $3,000 a year. That is the most you will ever have to pay," it said.

In the auto-happy period after World War II, however, Roosevelt's successors routinely upgraded the program, much the way Detroit upgraded its cars. In Lyndon Johnson's Great Society, policy analysts focused on the idea that Social Security payments ought to reflect the general increase in living standards. Ball published a paper in 1966 talking about a plan "to relate benefits to recent wages before retirement." In the 1970s, this real-wage peg, as technicians called it, became law.

After that, the formula for calculating workers' base pensions reflected not only inflation but also growth in the average real wage. Over time real wages went up. So a woman who follows her sister's career path won't get the pension her older sister receives; she will get more than her sister — a sunroof, as it were.

The Social Security program might have been able to afford this if American families had continued to produce three, four or five children. But they did not. Families shrank. And the dollars flowing into Social Security will fall short, eventually by trillions. Alan Greenspan's famous Social Security commission, of which Ball was a member, did little to address the real-wage problem.

But adjusting pensions for inflation alone, ending the real-wage increase, would address the challenge. Some would call such a move a cut — as Ball did. A more accurate description is a limit on growth to preclude painful future cuts. The peg adjustment would make Social Security a smaller part of Americans' retirement package a few decades from now. It would also erase at least two-thirds of the shortfall.

Many of the Great Society generation depict such tinkering as appalling. They are being unrealistic. Today's workers aren't expecting the Volvo. As long as a decade ago, a much-publicized poll suggested that more members of Generation X believed they would see a UFO than believed that Social Security would help them when they retired. A 2001 National Bureau of Economic Research paper, "Social Security Expectations and Retirement Saving Decisions," by Jeff Dominitz, Charles Manski and Jordan Heinz, reported similar attitudes: Only four in 10 30-year-olds expected to be eligible for Social Security. Such people would consider the same pension that their parents got a gift, not a cut. Such a modest pension fits well with FDR's original — humble — description.

The only thing preventing the peg change is politics. Republicans argue that if Social Security is to be reformed, the reform has to include privatization or personal accounts. Democrats, too, hold the peg change hostage to their goals; they see in pension reform a license to redistribute income. Ball's suggestion that estate tax revenue be used to pour extra funds into Social Security suits the latter strategy.

Americans have an exaggerated sense of respect for the New Dealers who created the original Social Security model. Questioning them or the Great Society heroes seems impolite. But this filial piety is increasingly costly. Overcome it, and we can all move forward.

Shlaes, a senior fellow in economic history, wrote 'The Forgotten Man: A New History of the Great Depression.' This column first appeared in The Washington Post.