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## UNITED STATES ECONOMIC OUTLOOK

### Quarterly Developments

## **U.S. ECONOMIC OUTLOOK**

As President Bush begins his second term in office, the domestic economy has become his priority. Whereas the President's first four years focused on ending a recession, and then waging a war on terror, the second-term agenda centers on reshaping government responsibilities and changing the way government is involved in the economy. Social security reform is President Bush's highest priority.

### **Social Security Reform**

The future funding shortfall in Social Security has gained preeminence as baby boomers are beginning to retire. The current system in which tax revenues are used to cover current retirees is projected to become insolvent by the latter half of this century.

- The US population is living longer today than in the 1940's when the system was devised, meaning that the average retiree spends more time in retirement than he or she did 65 years ago. In 1940, life expectancy at age 65 was an additional 12 years for men and 13 years for women. By 2075, life expectancy beyond age 65 is projected to be 20 years for men and 23 years for women.
- Long term demographic trends in the U.S. show that there will be fewer workers supporting more retirees. Lower fertility rates mean that by the year 2030 the ratio of workers to Social Security beneficiaries will have dropped from 5.1 in 1960 to 2.1. Under this scenario, payroll taxes will not cover benefit payments, and the value of Social Security assets will fall to zero.

Though details of the President's proposal have yet to be revealed, the introduction of personal accounts through which individuals can invest in stocks and bonds is thought to be the cornerstone of the reform. In addition to private accounts, the President has emphasized two other elements: that those at or near retirement ages won't see their benefits cut, and that payroll taxes won't be increased.

Despite these assurances, critics have already argued that there is no free lunch. Solving the funding problem of Social Security will require hard choices and, they add, the creation of private accounts will not deal with the solvency and sustainability of the Social Security fund. To be sure, a heated debate is expected in the coming months as the President gears up to overhaul the Social Security system.

### **Taxation**

- Taxation reform also figures prominently on President Bush's second term agenda. The President's priority is to make permanent the tax cuts passed on during his first term. In addition, new proposals geared to reducing marginal rates and reducing taxes on savings and investment are expected. The conceptual basis for these proposals is that they will spur capital accumulation, improvements in technology, and long term economic growth.

## **Federal Reserve Chairman**

Finally, a crucial second-term Presidential decision will be Alan Greenspan's successor. Greenspan's retirement in 2006 has already captured the attention of Washington. Who has the stature to be his successor? Who has the credibility to persuade financial markets? Who will be able to maneuver Washington politics and do what is necessary when pressures push in conflicting directions? Names such as those of Martin Feldstein and Glenn Hubbard have popped up as potential replacements. Regardless, Chairman Greenspan's ability to calm markets and to lead the Federal Reserve in the independent direction it needs will be difficult to match.