Social Security Watch

TRACKING THE NEXT BIG WASHINGTON REFORM

Keep Uncle Sam Out of the Stock Market

In his State of the Union address, President Clinton proposed investing some $700 billion of the Social Security Trust Fund in the stock market. Give him credit for admitting that the current program generates a rate of return on your "investment" that would cost a Wall Street money manager his job. The President's scheme for having Uncle Sam buy stocks directly, however, is riddled with economic and political perils.

In particular, his call for a Social Security portfolio "free from politics" is fanciful at best and another lie at worst. Portfolio managers in the private sector are required by law to maximize returns for future retirees. But the administrators of pension plans for state and local governments often pursue quite different goals.

Public-sector pension funds are littered with politically favored investments that have blown away in the economic winds. For instance, the Kansas Public Employees' Retirement System recently lost $65 million in Kansas-based Home Savings Association, $14 million in Tallgrass Technologies, and about $8 million in a local steel mill, reports Heritage Foundation analyst Daniel Mitchell. In 1990, the State of Connecticut Trust Fund put $25 million into Colt Industries, a local gunmaker. In 1993, Colt misfired, and the money vanished.

Public portfolios also are battered by political correctness. During the mid-1980s dozens of states, cities, and public universities ditched their shares in companies that conducted business in South Africa. Others were pressured to dump stocks of firms that helped produce nuclear weapons. Eleven states curbed investments in Northern Ireland. The city of Philadelphia sold its Texaco shares in 1996 when Jesse Jackson screamed "racism!" San Francisco has used its pension investments to pressure companies to change their corporate policies on sex and family issues.

Minnesota's public employees lost $2 million last year when their state fund dumped its tobacco holdings. In April 1998, New York State Comptroller Carl McCall said he would withhold his support at shareholders' meetings from the boards of Philip Morris, RJR Nabisco, and Loew's if they didn't negotiate a tobacco settlement with state prosecutors. In July, McCall and New York City Comptroller Alan Hevesi threatened to exclude Swiss banks from managing municipal pension funds and other New York assets unless the Swiss settled a lawsuit with Jewish groups over Holocaust-era dormant accounts. The Swiss banking industry caved in like a chocolate soufflé before the restrictions even took effect.

Conservative activists have joined in the fun, too. Last July, after family activists protested, the Texas State Board of Education decided to sell $46.4 million of Disney stock to protest violent films from Disney's Miramax subsidiary.

Squandering money on pet causes and distorting investment decisions for political reasons are not the only dangers of government portfolio management. Old-fashioned safe-cracking is also a serious problem. In fiscal years '93 and '94, California diverted $1.36 billion in pension contributions to balance its budget. New York State similarly siphoned its employees' retirement fund for $230 million in 1995. Just last summer, Chicago used $12.5 million in pension contributions for interest payments it owed creditors.

Can anyone trust Congress and the White House not to plunder a federal pension portfolio? A $700 billion honey pot will attract lobbyists, spending advocates, and PAC men like grizzly bears. Presidents, senators, and congressmen would gain a golden opportunity to sell Wall Street firms "access" to this largesse.

Activists on the left already are licking their chops over what could become government's biggest chow-down yet. The AFL-CIO's Gerald Shea has predicted that federal investment in the stock market would "have a good effect on how corporate America operates." Democratic Representative Jerrold Nadler of Manhattan's Upper West Side recently told *The Village Voice* that he savored this potential federal feast: "You're saying the government will have more influence to pressure for more decent, socially responsible corporate behavior. That's terrible?"

Add to these problems the usual inefficiencies and corruptions that plague government spending, and it becomes impossible to deny the folly of allowing federal bureaucrats to invest America's retirement nest eggs. Already, the economic cronyism practiced on a limited scale by state and local governments wastes billions of dollars. (Yale professor Roberta Romano estimates $28 billion in total losses just between 1985 and '89.) If the federal government were allowed to invest Social Security contributions, vastly larger distortions would result. "Even with Herculean efforts, I doubt if it would be feasible to insulate, over the long run, the trust funds from political pressure—direct and indirect—to allocate capital to less than its most productive use," warned Federal Reserve Chairman Alan Greenspan on January 28. Indeed, he noted, federal investment of Social Security funds "would arguably put at risk the efficiency of our capital markets, and thus our economy."

—Deroy Murdock

The Case for a Tax Cut NOW

(AND TAX REFORM NOT LONG AFTER)

By Lawrence B. Lindsey

U.S. leaders are relying too heavily on an expansive monetary policy to sustain our growing economy. Fiscal policies, meanwhile, are quite tight. While that has helped produce a budget surplus by squeezing lots of dollars out of taxpayers, it is straining the larger economy and putting the present expansion at risk. The most important single action the present Congress could undertake would be to alleviate some of the strain with a major across-the-board reduction in tax rates.

This tax reduction would significantly ease the intense pressure now placed on monetary policy to sustain the current American economic expansion, and indirectly, the growth in global output. In so doing, it would restore a much more prudent and balanced mix of fiscal and monetary policy to our nation. It should be viewed as an insurance policy designed to preserve the current U.S. expansion until such time as economic conditions improve abroad.

An across-the-board tax cut is not a substitute for much needed reform of our tax system. I would hope Congress might begin that process as well. But given the long lead time involved in preparing and enacting such legislation, I do not believe we can reasonably expect fundamental tax reform legislation to be passed quickly enough to meet the needs of the present business cycle. Fundamental tax reform would be a boon to the long-term growth of our nation's economy. But our most important problem is not our economy's long-term health—which I believe to be quite promising—it is the massive imbalance that has emerged in our economy, which could derail our present business-cycle expansion.

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As recently as 1996, the Congressional Budget Office projected that the upcoming year's budget deficit would be roughly $250 billion. Instead, we now project a surplus of some $50 billion.

One reason for this surprise has been improved economic growth. The economy has grown at a real rate of about 3.6 percent over the last three years, instead of the expected 2.5 percent. Thus, GDP is about 3.5 percent larger than one might have expected just three years ago.

> IN THE LAST THREE YEARS, PERSONAL INCOME TAXES HAVE SHOT UP 43 PERCENT—TWO AND ONE-HALF TIMES FASTER THAN PERSONAL INCOME. THE SHARE OF ECONOMIC GROWTH GOING TO WASHINGTON IS NOW AT A RECORD LEVEL.

More importantly, the federal government is scooping up a sharply bigger share of economic production in taxes. The fraction of GDP going to federal taxes has risen from 20.0 percent in 1995 to 21.8 percent in 1998. This factor is roughly three times as important as the extra economic growth in producing today's unanticipated budget surplus. Or to put it differently, extra federal taxes took a third of the total growth in GDP between 1995 and '98. Federal tax revenue rose in this period by $390 billion—an extraordinary expansion of taxation, and one that mostly came from taxes on individual incomes.

Corporate income taxes and social insurance taxes like Social Security have risen at about the same rate as the GDP; other taxes, such as excises, have been relatively static. But in the last three years personal income taxes have shot up 43 percent—two and one-half times faster than personal income.

While we cannot know precisely who paid these extra taxes, I estimate that most of this surge comes from the upper brackets of the income tax and also the special capital gains tax rate. (Capital gains tax *revenues* have boomed as the tax *rate* on capital gains has been cut.) Together, the share of federal taxes raised from the special capital gains tax and upper-bracket income taxpayers increased from about 31 percent in 1995 to 36 percent in '98.

The primary cause is the enormous run-up in the stock market. The Dow Jones Industrial Average has roughly doubled since 1995. The Standard & Poor's index has grown even faster. (Strikingly, while the stock market has doubled, taxes from corporate profits—which closely track corporate profits—have risen only 15 percent, or roughly in line with GDP. So the boom in the stock market is not linked to greater corporate profitability.)

The net result: The government is collecting a record amount of revenue relative to the size of the economy. Both tax burdens and the share of economic growth going to federal revenue are now at record levels. A disproportionate share