# Nest Eggs, Over Easy

*Everyone who still wishes your Social Security benefits were invested in the stock market, raise your hand.*

**BY ROBERT SHAPIRO**

RARELY DO POLICYMAKERS GET THE chance to test the viability of a controversial proposal before it's enacted. But that's what happened on September 11. Right up until then, Washington was rushing headlong into a knock-down-drag-out debate over the Bush administration's proposal to allow Americans to invest a portion of their payroll taxes in private accounts. The administration was promising that the stock market, over time, would produce better returns than money held in the Social Security trust fund.

In turn, those private accounts, supporters have argued, would make up for the deficits threatening the Social Security trust fund in another decade or so, when the baby boomers start to retire. The president himself has shown no pretense of objectivity in the matter, appointing to his Commission to Strengthen Social Security only those who already support partial privatization.

During last year's presidential campaign, privatization might have been considered with a straight face, if only because the risks involved in sinking one's retirement nest egg in the stock market seemed like a thing of the past. Not investing in the exuberant market, in fact, seemed almost foolhardy. Then came the collapse of the NASDAQ, followed by September 11, and the biggest one-week plunge in the Dow since the Depression. Those events have effectively wiped out the investments of thousands of Americans.

Former Federal Reserve Vice Chair Alan Blinder has calculated (with others) that the annuity value of a retirement account for someone retiring in March 2001 would have been one-third less than that of someone who happened to retire 12 months earlier. The decline would be even more drastic—roughly half—if one happened to retire six months later, in October 2001.

Today, the notion that millions of voters would throw their support behind a libertarian plan that would cast aside the security of a government pension seems far-fetched. But diehard privatizers are undeterred. Michael Tanner, director of the Cato Institute's Project on Social Security Privatization, insists that recent events have not killed privatization. "In the short term it will probably scare some people," he said. "In the long term, it could actually be beneficial. The market will recover and it will show people that down markets are not forever."

Besides, he argues, "There is no guarantee of secure and known benefits in the present Social Security system. In the current Social Security system, people have no legal rights to benefits. Congress is free to change benefits at any time."

The White House is apparently toeing that line as well. In the weeks after the World Trade Center and Pentagon attacks, former New York Senator Daniel Patrick Moynihan, chairman of the President's Commission to Strengthen Social Security, moved to postpone the commission's report until next spring, given the country's new political focus. But the White House wants to push forward, still firm in its belief that privatization is a viable policy option.

It will have to make a pretty strong case to people like 59-year-old Rita Bregman, who was recently profiled

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in *The Washington Post* because she was on the verge of retirement until her stock portfolio plummeted from $120,000 to $4,154 in the course of a year. Instead of retiring, Bregman has had to take a second job. For her, traditional Social Security probably looks better and better.

Like it or not, the Bush administration is eventually going to have to reboot. But so too will all the other ideological factions warring over what to do about Social Security. As with so much else, the events of September 11 have shaken the foundations of the debate over the future of America's biggest social program. With a little luck, this might actually lead to a real solution.

## Warring Factions

Before September 11, nearly everyone acknowledged that Social Security faced what Bill Clinton used to call a "high-class problem." We're living longer and having fewer children, and so the system faces a financing challenge as the huge baby boom generation prepares to retire and collect its benefits from the less numerous Generation X. Apart from that, the major players in the debate haven't seen eye to eye on virtually anything, including whether this prospect calls for major reforms.

The factions in this debate generally fall into three camps. First are the privatizers, headed by President Bush. Their idea of changing Social Security to allow recipients to invest in the stock market is headed politically in the same direction as the stock market: downward.

Second are what might be called Washington's professional Scrooges, people like *Newsweek* columnist Robert Samuelson and organizations like the Concord Coalition. These folks see in Social Security another exasperating example of trans-generational self-indulgence. They've long argued that the program can be rescued, and our characters cleansed, only by some bracing benefit cuts for the boomers and salutary tax increases for the Gen-Xers. But with incomes slowing and Americans feeling unaccustomedly vulnerable, Congress is also not about to pass—nor should it—hefty benefit cuts for boomers and tax increases aimed at Generations X and Y to pay for the baby-boomer retirement.

The third camp is made up of traditional liberals, people like Henry Aaron at the Brookings Institution and the Democratic leadership in the House. Still misty-eyed and sometimes misty-minded for the glory days of FDR, they oppose virtually any change to Social Security, no matter how small. Traditional liberals believe that the retirement system can come through this demographic trial like a champion if we save the Social Security surplus, repeal the conservatives' latest pesky tax cuts for the rich, and pour the savings into the Social Security trust fund. This position has also become more tenuous since September 11, because with the full backing of Democrats, we are now back to spending the Social Security surplus to fund the war and stimulate a faltering economy.

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Truth be told, I have sympathized with all three camps in various ways and at different points. Now it seems possible that the country's post-September 11 perspective could help us reconcile the three conflicting views. With a few politically achievable tweaks to the current Social Security tax and benefit formulas, the addition of a politically attractive new program to subsidize private saving, a little luck, and sound economic policy, today's younger workers can finance the boomers' retirement without making any notably greater sacrifices than the boomers did, and without having to accept greatly diminished benefits for themselves.

## Scrooge's Medicine

My own political education about Social Security began when I was a tax and budget assistant to Moynihan. One of the lessons the senator taught me was to take great care in changing a program that, by virtually ending poverty among the elderly, represents the single most successful federal program of modern times. Though Moynihan himself is on the president's commission, his fellow commissioners at least seem to have forgotten that lesson.

The privatizers begin with a kernel of truth: Government should encourage young people to invest at least some of their savings in the market, as the affluent do today, and not rely totally on Social Security to pay their retirement bills. What doesn't make sense is their way of achieving this goal: diverting two percentage points of the Social Security tax, about 15 percent of the system's annual revenue stream, to personal accounts. The stock market's recent free fall illustrates only one of the hazards. Such sharp market declines are neither unusual, nor always short-lived, nor necessarily tied to high-flying investments. Since 1950, there have been 12 years in which the real value of the S&P 500—a broad index of blue chip companies—was at least 40 percent lower than it had been 10 years earlier.

But let's say you have some of your Social Security money in a personal investment account and are lucky enough to retire in a year when the market is up. Your return still won't necessarily beat by much what it would have been under normal Social Security. That's because the brokerage fees to maintain your account come off the top. Even a one-percent annual fee would reduce your final balance by 25 percent—a fact privatizers don't like to advertise.

The worst thing about privatization is what it would do to the Social Security system as a whole. Every dollar diverted to private accounts is a dollar not available to pay current and future beneficiaries. This would leave a funding hole of about $3 trillion over the next 20 years—in addition to the trillions in deficits Social Security will rack up in future decades with or without privatization. Since conservatives know how to add and subtract as well as anyone, they can only mean to cut the mainstream Social Security benefit as well, and pretty steeply.

One who admits that is Cato's Tanner, who says, "It's almost certain that benefits are going to be reduced substantially in the future." Even if those cuts were limited to late boomers and Gen-Xers with new private accounts, their basic benefit would fall while the rest of their retirement security would be hostage to a lot of, ahem, market risk.

Of course, even if you take away the possibility of partial privatization (and you should, because it's not going to happen), Social Security must still confront the day in 2016 when payroll taxes no longer cover benefits, with trillions of dollars in shortfalls mounting indefinitely thereafter. We might have solved the problem for quite a while by using non-payroll-tax revenues from huge budget surpluses over the next decade. But, oops, the president and Congress have spent them on tax cuts that will amount to $4- to $5 trillion over the next 20 years, as well as on all the security, bailouts, and stimulus packages that have followed the September terror.

Enter the second party to this debate: the fiscal Scrooges. Their answer to the funding shortfall has long been equal-opportunity austerity: Cut the annual inflation adjustment for every retiree's check and raise the retirement age for the rest of us, so we all work until age 69 or 70. To fill the rest of the funding gap, the Scrooges suggest we simply get rid of some stray defense systems and disband a few battalions, close some surplus housing and education programs, and some extraneous tax deductions.

This ascetic approach to reform may add up on a spreadsheet, but it comes up against another lesson that I learned from Moynihan a year or so before he co-chaired his first Social Security commission in 1983: If you try to tinker with the country's most successful and popular program without a broad national consensus, you will fail. I learned that watching him in the great 1981 budget battle as he dealt a setback to the invincible Ronald Reagan. In the Reaganites' only significant spending defeat that year, Moynihan successfully headed off all the cuts in, what else, Social Security.

The Scrooges might just convince editorialists and affluent readers that the current system will be in peril unless we embrace their formula. But for now, one of the rare points on which conservatives and liberals agree—including President Bush, Senate leaders Tom Daschle and Trent Lott, and House chieftains Richard Gephardt and Dennis Hastert—is in their solid opposition to asking Americans to work longer, pay higher taxes, or give up spending programs to create private accounts or just keep the system going. That's virtually a death sentence for the austerity approach. And, of course, given the shape the economy is in, taking the Scrooge's medicine anytime soon could plunge us into a deeper and longer recession.

That leaves the love-it-and-leave-it-alone liberals and their position that no cuts in benefits are needed. Social Security can be saved in the long run, they say, by using the Social Security surpluses to build up the trust fund and running large non-Social Security surpluses to pay down the debt. That will leave the revenues now slated for interest payments to help pay benefits, underwrite a larger economy that will generate more payroll taxes, and make it easier for future generations to borrow or pay more taxes to finance the baby boomers' benefits.

Of course, it's fair to point out that we are currently spending the Social Security surplus. What is unfair is the charge that privatizers and the Bush commission make: that the whole idea of a Social Security trust fund is a sham.

The idea for the trust fund came from the 1983 commission that Moynihan chaired and was put into law by Congress that year. The 1983 fix raised, among other things, the rate of the payroll tax taken out of everybody's paycheck. The trillions in extra dollars that flowed into the trust fund were lent to the Treasury to fund the federal government's chronic deficits throughout the 1980s and much of the 1990s. And since 1999, when the deficit disappeared, they have been used to pay down the government's accumulated debt. The IOUs for that money lent to the Treasury now sit in the Social Security trust fund in the form of special bonds. There are $1 trillion in such bonds today, and the trust fund is projected to reach more than $3 trillion by the crunch year 2016, when the payroll tax revenues coming in will no longer cover the benefit payments going out.

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The president's commission on Social Security has made the truly jaw-dropping claim that these bonds are not "real assets." By this, the commissioners apparently mean that government paper has less real economic value than private stocks or bonds, because government has to use tax revenues, borrowing, or the proceeds from spending cuts to redeem them.

To this claim, liberals pull themselves upright and point out, correctly, that the trust fund trillions are held in securities backed by the full faith and credit of the United States government, which makes them as real as a dollar bill. These securities are also real enough to provide the most secure holdings of every bank and corporation in the country, and to serve as the reserve currency for most other nations.

The notion that the trust fund is not "real" comes from the tenets of the small band of libertarians who started and still sustain the crusade to privatize Social Security. Behind this claim lies a serious political strategy. The trust fund is the linchpin for the long-term viability of a program that represents the foundation of the New Deal and the most successful initiative of the welfare state. If the trust fund is a scam and the program can't be sustained, the political philosophy and the political party that created and embraced it forfeit much of their legitimacy.

## The Secret Plot To Kill Government

For dedicated privatizers, this debate isn't about just Social Security. It's also about health-care reform, tort liability, and environmental regulation; it's about the corporate tax and every other economic-related aspect of the conservative and libertarian agendas. In fact, the ambitions of those mounting this critique go even further: If the full faith and credit of government has no reality, government itself loses some of its legitimacy, especially its claim to any authority in economic life. And where would that take us?

Appalling as these claims are, my New Democrat radar still senses a tiny element of truth in the libertarians' nihilist position on the trust fund. When General Motors or Cisco has to redeem corporate paper, it finds the resources by doing essentially the same as government: drawing on its cash reserves, cutting spending somewhere, raising some of its prices, or borrowing more. But when GM or Cisco cuts spending or raises prices, its bondholders aren't affected. If the government cuts spending or raises taxes to fill a shortfall for Social Security, some of the beneficiaries will likely bear some of the direct costs.

Mostly, however, the libertarian attack is simply wrong, as well as a little dangerous. Securities backed by the government's full faith and credit have real value; in fact, they have greater value than the securities issued by General Motors or Cisco, since there's virtually no likelihood of ultimate default on U.S. government paper. Furthermore, the strategy of accumulating trust fund assets is not a sham; it makes eminent sense for Social Security. All those excess revenues reduce the deficit or, when the rest of the budget is balanced, produce surpluses that reduce the national debt.

Either way, it frees up more funds in the future to pay for Social Security by reducing future interest payments on the debt. It also increases payroll tax receipts down the line by expanding the capital available for business investment, which in turn tends to raise people's productivity and incomes—and therefore the payroll taxes they pay to support Social Security. The bigger the trust fund, the later will be the day of reckoning when we have to cut spending, raise taxes or borrow to make up the difference between what comes and what goes out of Social

Security every year.

Of course, the trust fund strategy makes economic sense: It was Alan Greenspan, after all, who co-chaired the 1983 commission with Moynihan.

## Gimme Three Steps

The trust fund is not enough. Fifteen to 20 years from now, Social Security's annual receipts won't cover the cost of its benefits. Trust fund assets will have to be redeemed, and the funds to do so will have to come from somewhere. Today, those running the government are for the most part baby boomers. We boomers can ease the burden on those who come after us by taking three steps, guided by what is sensible in each of the positions held by the three warring factions.

First, let's grant that the liberals are basically right about the long-term fiscal path we need to be on. We need to save the Social Security surpluses to pay down the national debt—a debt foisted on the country mainly by the political generation born or raised in the Depression and World War II, the same great generation that gave itself the best deal on Social Security. If we do that, we will leave a larger and stronger economy that can more easily generate revenues for our retirement benefits. Getting rid of the debt will also save our children hundreds of billions of dollars a year in interest payments, significantly pushing back the day of reckoning on redeeming those trust fund assets. Finally, if the next generation decides to borrow the funds to redeem those assets, becoming debt-free first will make it a lot cheaper to do so.

Paying down the debt is not unpatriotic at a time when we also have to pay a great deal more to confront terrorism. We can spend what is required to defend our country and civilization, without sacrificing the long-term health of both the economy and the Social Security program. There are other and better sources for these funds, including some of the large tax relief recently enacted for high-income people but not yet implemented.

Second, let's act on the kernel of truth behind the privatizers' agenda: Government should actively try to get young people to rely less on Social Security for their retirement needs, and more on their own private savings. The way to do this is to create 401(k) accounts for everyone outside Social Security, just like current 401(k)s. Today, about 40 percent of Americans work for employers that have set up 401(k)s. Let's make them universal so everyone can save and invest tax-free, regardless of where—or whether—they work. Let's have the government match part of these personal savings, just like most employers do, for their highest-paid employees. And let's get poor Americans, who have the most pressing need to save, started by having the government make the initial contribution. In a compromise that everyone but intractable supply siders and libertarians should welcome, conservatives get universal private accounts and liberals get to preserve the current system. And it could be financed by simply keeping the current 39 percent top income-tax rate in place.

So, at the cost of not cutting taxes for the richest two percent, we can make every working American a long-term investor, without jeopardizing Social Security. Moreover, this approach would particularly help Gen-Xers and Gen-Yers build their nest eggs on top of Social Security.

Third, give the Scrooges part of their due. We don't need to cut every retiree's cost of living adjustment or make everyone wait until they're 70 to retire. It's unnecessary and would be unfair to retirees living on smaller incomes, who work at physically demanding jobs that often require them to retire earlier, and who tend to die earlier, too. But we should push for fairer, more modest, and more politically achievable fixes: reducing the inflation adjustment for higher-income seniors, taxing affluent people's benefits like ordinary income, or raising the retirement age slightly.

One more thing: We should take back economic policy from President Bush's friends so it actively promotes higher productivity and growth. In place of tax cuts for the wealthy and tax breaks for oil and other favored industries, we could focus on selected new-economy investments in research and development, education and training while paying down the debt. Instead of caving in to demands for protection from steel makers and others, we can try leading the world on trade again, with a new multilateral round of talks and initiatives for new international rules in intellectual property and antitrust. Rather than coddle today's new economy giants, we could break open the markets for cable and other broadband access and open up more spectrum for third-generation wireless.

If we follow this course, Generations X and Y will be able to do their duty to the baby boomers, as the baby boomers did for the World War II generation. And they can do it without paying higher payroll taxes or suffering lower growth. We can keep Social Security sound and well for decades to come and preserve its great social achievement. And that's about as good a deal as any generation can expect.

# Memo *of the* Month

All employees State

U. S. Department of State

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<u>Clarification of Leave Policy for September 11, 2001</u>

HR/ER has received numerous calls regarding the leave policy for September 11, 2001 issued by the Office of Personnel Management (OPM). HR/ER would like to clarify the following:

If a non-emergency employee--

- had scheduled annual leave for September 11, 2001 for the entire workday, leave should continue to be charged for the entire workday;

called in sick at the beginning of the workday, he/she would continue to be charged sick leave for the entire workday;

- had scheduled leave for the morning of the September 11, 2001 but had intended to return to work in the afternoon, leave should be charged only up to the point of the Department's official dismissal and evacuation (1 0:1.5 a.m.). The rest of the workday is charged to excused absence.

departed the office before official dismissal shall be charged leave from the point of departure until the tune of dismissal.*

Emergency employees are normally expected to report to work on time and are **charged annual** leave for failure to report to work. However, due to the unusual circumstances of September 11, supervisors should grant excused absence to emergency employees who were evacuated and unable to return to the building.

Additional questions regarding the leave policy for September 11 can be directed to Anita Brown, HR/ER, on 202-261-8171.

* Supervisors/managers can grant excused absence without loss of pay or charge to leave to avoid hardships. For example, excused absence can be granted to employees who needed to leave before official announcement of dismissal because younger children were being released from school/ child care centers earlier than the announced dismissal time and no alternative form of child care was available.