Facts and myths about Bush’s plan for Social Security privatization

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The centerpiece of the domestic policies outlined in Bush’s State of the Union speech Wednesday is the partial privatization of Social Security. While the details of the White House plan have not yet been finalized, the broad outlines include: (1) the diversion of Social Security payroll taxes to the creation of private investment accounts; (2) government borrowing to sustain current benefit payments (which would otherwise be paid for by the payroll taxes); and (3) sharp cuts in benefit payments for future retirees (with the claim that income from their private accounts will make up for it).

Bush and the congressional Republicans are selling the plan as an alternative to a fiscal crisis which they claim will force huge cuts in benefits or huge increases in payroll taxes when today’s young workers are approaching retirement. Various factions of the Republican Party differ over how much of the payroll tax should be diverted, how large the private accounts should be, and how severely future benefits should be cut, with the *Wall Street Journal,* the Cato Institute and other spokesmen for the extreme right seeking the largest possible accounts.

In a recent statement, Bush claimed, “The system will be in the red in 13 years, and in 2042 the system will be broke.” But if a 27 percent shortfall means the system is broke, then what of the federal government budget which Bush will present later this month? The federal government will run a deficit of something close to the level cited by Bush as dangerous—not in 2042 but in 2005! (The projected $427 billion deficit is 21 percent of a $2 trillion budget. Add an expected $100 billion more for war in Iraq and Afghanistan, not included in the budget, and the deficit reaches 26 percent).

Bush blurted out the real content of his proposed “reform” at his economic summit in December, when he remarked: “The question is whether or not our society has got the will necessary to adjust from a defined benefit plan to a defined contribution plan.” In other words, for all the rhetoric about protecting the elderly, the essence of his policy is to shift the American population from a federal pension plan paying guaranteed benefits to a variant of the 401(k) plans which make benefits hostage to the ups and downs of the financial markets.

Congressional Democrats have generally opposed the Bush plan in its current form, but a significant number have backed the creation of private accounts through an increase in the payroll tax or more government borrowing, an approached they have dubbed “Social Security plus.” On the eve of the State of the Union address, Senate Minority Leader Harry Reid (Democrat from Nevada) announced that Senate Democrats had enough votes—40 of the 44 Democrats would be sufficient—to block any diversion of payroll taxes into private accounts.

The Bush administration announced a political campaign to sell the Social Security plan in which Bush would tour at least five of the states he carried in the November election, Florida, Arkansas, Nebraska, North Dakota, and Montana, seeking to bring pressure on the seven Democratic senators from those states.

What is Social Security?

Social Security was the centerpiece of Franklin Roosevelt’s New Deal policies. Established in 1935, it is not, strictly speaking, an insurance program, but rather provides old-age pensions based on intergenerational transfers. Today’s retirees paid Social Security payroll taxes during their working years, which went to fund the pension payments for their parents. They in turn now receive pensions financed by the payroll taxes of their children, the current generation at work.

The program is now the foundation for the economic position of retired workers and the disabled in the United States (disability coverage was added after World War II). Nearly 48 million people—33 million retirees and their dependents, 7 million survivors, usually spouses, and 8 million disabled currently receive Social Security benefits.

The average annual benefit is $11,000, with a maximum of $23,000. The current retirement age is 66, although reduced benefits are available at age 62. The retirement age is scheduled to increase gradually, a few months every few years, until it hits 67 in 2022.

Social Security is the sole source of income for 20 percent of the elderly, and for 38 percent of the black and Hispanic elderly. It accounts for more than half of total income for two-thirds of the elderly. Along with Medicare, which pays the majority of medical bills for the elderly, Social Security is largely responsible for the sharp reduction in poverty rates among the elderly over the past half century. By one calculation, without Social Security the poverty rate among today’s elderly would rise from the present 10 percent to 50 percent.

The Social Security system is one of the last remaining institutions in America that works to mitigate rather than exacerbate social inequality. Benefits are paid out on a progressive scale, with lower-paid workers receiving a higher percentage of their average annual wage before retirement (about 57 percent) than higher-paid workers (the rate drops off in stages to 36 percent).

Is there a Social Security crisis?

Not in the sense suggested by the Bush administration, which is waging a scare campaign about the prospective collapse or bankruptcy of the system in order to stampede public opinion into backing its privatization plan.

The facts are these: under the 1935 Social Security Act, the trustees of the system measure solvency by projecting taxes collected and benefits paid over a 75-year period. The trustees present three projections, based on pessimistic, middle-of-the-road and optimistic economic assumptions, respectively.

The middle-ground forecast is that by 2018, the system will begin to pay out more in benefits than it receives in taxes, and will be compelled to draw on the surplus in the Social Security Trust Fund. In 2042 (2052 according to a later estimate by the Congressional Budget Office) the Trust Fund would be exhausted, and only 70 percent of benefits would be funded by payroll tax revenues, leaving 30 percent to be cut or funded by other sources.

The projection is exactly that—a very rough guess based on assumptions of an increasingly arbitrary character, the further out into the future the forecast attempts to reach. (One can imagine, for instance, the problematic character of an effort to forecast conditions in the year 2005 from a point 75 years earlier, at the depths of the Great Depression in 1930).

One of the assumptions of the projection by the Social Security trustees is that economic growth in the United States will average 1.8 percent throughout the period from 2015 to 2080, about half the historical rate over the last century. Even a slightly more optimistic assumption—say, 2.5 percent, a full percentage point lower than the historical average—and the supposed "crisis" of Social Security disappears.

As for the current state of Social Security, the Trust Fund has a surplus of over $1.5 trillion, accumulated from the wages of the baby boom generation (1946-1965), which will begin retiring in large numbers in 2008. The Trust Fund is ample to pay out the retirement benefits for the baby boomers—who would be from 87 to 106 years old by the time of the projected "crisis." The shortfall, if any, would affect the next generation, those under 40 today.

There is a broader crisis facing retired workers, but that stems from the crisis of profit system as a whole. American workers have long depended on three sources of income in retirement: Social Security, employer-sponsored pensions, and personal savings. Social Security, the only one guaranteed by the state, is the only leg of this tripod that is comparatively sound.

Because of the stagnation of wage levels and the increasing pressure on working class living standards, personal savings have plunged from 11 percent of disposable income 20 years ago to only 1½ percent today. Less than half of private-sector workers have any employment-based retirement plan, and the majority of these are 401(k) plans whose benefits are determined by the performance of the stock and bond markets, and are not guaranteed.

Traditional defined-benefit plans cover less than 20 percent of current workers, and collectively, they have a funding gap of $450 billion. The Pension Benefit Guaranty Corporation, the federal agency established to provide a safety net for these plans, has incurred a $23 billion deficit, mainly from bailing out the steel and airline industry funds. The Bush administration has allowed major employers to escape their pension obligations by filing for bankruptcy, and the entire edifice of such private plans will collapse long before any financial strains are felt in Social Security. But the White House is sounding no alarms here, since the default on pension plans redounds to the benefit of the giant corporations.

Why does the Bush administration claim Social Security is going bankrupt?

The Bush administration seeks to foment fears of a crisis in order to engineer a radical reversal of the policies of the New Deal, initially privatizing part of Social Security, ultimately eliminating the public pension system entirely. This campaign of fear-mongering has been widely compared, even in the tame American media, to the methods employed in the run-up to the invasion of Iraq, when White House spokesmen repeatedly warned of the imminent threat of Saddam Hussein's weapons of mass destruction, which turned out not to exist.

As in the case of Iraq, the proposed remedy has no logical relation to the purported threat. If Saddam Hussein had actually possessed weapons of mass destruction, deploying hundreds of thousands of American troops within range of those weapons would have been suicidal. In similar fashion, if Social Security were actually running out of money, diverting as much as $2 trillion in payroll tax revenues into private investment accounts would make the crisis that much worse.

Indeed, that is precisely the intention of Bush's plan to "save" Social Security. Its principal architects are right-wing ideologues, many of whom in the 1970s and 1980s openly advocated the program's abolition. Today they settled on a strategy of killing Social Security slowly and by stealth. (A recent article in the *Texas Observer* recalled a little-known episode in Bush's past: in his unsuccessful campaign for Congress in 1978, Bush argued that Social Security would go broke by 1988 unless private accounts were established.)

The special assistant to the president charged with responsibility for selling the Social Security "reform" plan, Charles P. Blahous, previously headed the Alliance for Worker Retirement Security. This is the Orwellian name of a business lobby that has long pushed privatization.

Another longtime champion of Social Security privatization, Andrew G. Biggs, once an analyst at the Cato Institute, is now the associate commissioner of Social Security for retirement policy. Just before he took that position, Biggs denounced the American Association of Retired Persons (AARP) for "spreading disinformation" because it was pointing out the risks of private accounts.

Now in office, Biggs authored an official policy brief that called for Social Security Administration (SSA) personnel to become mouthpieces for Bush administration propaganda about the impending bankruptcy of Social Security. The document declared that SSA managers should "discuss solvency issues at staff meetings," and should "insert solvency messages in all Social Security publications."

Right-wing spokesmen have been increasingly unguarded about their intention of destroying Social Security, and the political significance they attach to it. The *New York Times* quoted Stephen Moore, former president of the anti-tax Club for Growth, to this effect: "Social Security is the soft underbelly of the welfare state. If you can jab your spear through that, you can undermine the whole welfare state."

Grover Norquist, another right-wing political operative and president of Americans for Tax Reform, cynically dismissed the bankruptcy claim as a pretext. "Social Security should be reformed not because the system is going broke but because it's a lousy program," he declared.

Perhaps the stupidest and most economically illiterate comments came from former House speaker Newt Gingrich, in an interview with the *New York Times*. "The accounts will create the first 100 percent capitalist society in history," he claimed. "Fifty years from now, relatively poor Americans for the first time will have their own personal savings; they'll see the power of interest buildup over time and appreciate the importance of property."

Such remarks only demonstrate the self-satisfied complacency of the privileged in a society where economic inequality has reached dimensions not seen since the days of the robber barons. Mr. Gingrich overlooks the fact that the essence of capitalism is the polarization of society into two antagonistic camps: an increasingly narrow stratum of capitalist owners which accumulates ever-greater wealth, and the vast majority of the population, with nothing to sell but its labor power. A few dollars, or a few thousand, in a personal retirement account will no more transform a worker into a capitalist than the 401(k) accounts that have largely replaced pension plans for most working people.

What would be the effect of the private investment accounts Bush advocates?

The two main claims of privatization proponents are that private accounts would increase national savings, thereby boosting investment and economic growth, and that private accounts would pay a higher rate of return than the Social Security Trust Fund, which is invested in Treasury notes. Both claims are bogus.

Because a substantial portion of the payroll tax would be diverted to creating private accounts, the federal government would have to borrow the money needed to keep making benefit payments. This borrowing is accomplished by selling government bonds. In effect, investors would be exchanging one set of paper—stocks purchased by the new private accounts—for another set of paper, Treasury bills. No real new value would be created, only profits for big investors generated by an increase in paper values. There would be no greater pool of savings to finance investment.

As for the promised high rates of return—if stocks were so lucrative, why would big capitalists and investment banks, the institutions which would loan the trillions of dollars the government would borrow to set up private accounts, agree to buy government bonds instead of investing their capital in the stock market themselves?

New York Times columnist Paul Krugman commented: "So privatizers are in effect asserting that politicians are smart—they know that stocks are a much better investment than bonds—while private investors are stupid, and will swap their valuable stocks for much less valuable government bonds. Isn't such an assertion very peculiar coming from people who claim to trust markets?"

Krugman lucidly explained what he called the "privatizers' Catch-22" in a column February 1. The projections of Social Security bankruptcy assume an average growth rate over 75 years of 1.8 percent. But the privatization scenarios assume that investing in stocks will yield a much higher rate of return than government bonds, as much as 6.5 percent after inflation. The two assumptions are incompatible, unless one is prepared to assume that stock prices can rocket upwards indefinitely while the real economy creeps along at a much slower pace.

Krugman writes: "The price-earnings ratio—the value of a company's stock, divided by its profits—is widely used to assess whether a stock is overvalued or undervalued. Historically, that ratio averaged about 14. Today it's about 20. Where would it have to go to yield a 6.5 percent rate of return? ... by 2050, the price-earnings ratio would have to rise to about 70. By 2060, it would have to be more than 100. In other words, to believe in a privatization-friendly rate of return, you have to believe that half a century from now, the average stock will be priced like technology stocks at the height of the Internet bubble—and that stock prices will nonetheless keep on rising."

The White House itself admitted that privatization has nothing to do with solving the alleged fiscal crisis of Social Security, in a memo drafted by Peter Wehner, a Bush political aide, which was distributed to right-wing lobbyists in Washington and then leaked to the media. "We simply cannot solve the Social Security problem with Personal Retirement Accounts alone," he wrote. "If the goal is permanent solvency and sustainability—as we believe it should be—then Personal Retirements Accounts, for all their virtues, are insufficient to that task." Wehner went on to state that significant cuts in benefits would be required.

The final element in the new accounts is, as in every significant policy initiative of the Bush administrative, the enrichment of the American financial oligarchy.

A January 30 article in the *Los Angeles Times* brought to light a 1983 Cato Institute article that advocated a "reform strategy" based on "guerrilla warfare against both the current Social Security system and the coalition that supports it." It called for a propaganda campaign "to demonstrate the weaknesses of the current system," adding that "building a constituency for Social Security reform requires mobilizing the various coalitions that stand to benefit from the change.... The business community and financial institutions, in particular, would be an obvious element in the constituency."

According to one authoritative estimate, the pumping of trillions and trillions of dollars into private investment accounts will generate colossal income to Wall Street—$940 billion in fees over the next 75 years, to say nothing of the ample opportunities for outright fraud and swindling as hundreds of millions of inexperienced, small-scale "investors" try to make their way through the stock exchange.