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Why Bush is wrong

His Social Security reforms are neither 'social' nor 'secure'

Social Security is the cornerstone of life for nearly 48 million people - retirees, dependents, survivors of deceased workers, and the disabled - all of whom receive a check like clockwork every month. Millions more will come to rely on those checks in the years ahead.

Many don't think much about that fact, and few realize just how much of a nest egg they're going to need. An American reaching the retirement age of 65 today has an average life expectancy of 18 more years, which means that roughly half of those who reach 65 can expect to live longer than 18 years. Four out of 10 have no nonwork-related retirement savings. Six out of 10 haven't even tried to estimate what they'll need. They rely vaguely on Social Security, but how far will it carry them? How serious is the "crisis" they hear about? What are the implications of "reform?"

Social Security pensions were indexed to the rate of inflation in the 1960s and 1970s, dramatically diminishing poverty among the elderly. Now only 10% of those over 65 live in poverty - 2 points lower than the national poverty rate. Roughly two thirds of people age 65 and over depend on Social Security for at least half their income, and roughly 20% rely on it for their entire income.

Currently, the payroll tax brings in more dollars than it pays out in benefits. The surplus, roughly \$180 billion a year, is invested in treasury securities and deposited into a trust fund, which holds more than \$1.5 trillion of these notes. As baby boomers begin to retire, the system will go into deficit around 2018, requiring drawing down on the fund. By that time the fund will exceed \$3 trillion, so it will be in the black until around 2042, using the Social Security Administration's conservative economic and demographic assumptions, or 2052, using the assumptions of the nonpartisan Congressional Budget Office. Even if the system exhausts its reserves, payroll taxes will roll in, enabling at least 73% of scheduled benefits to be paid out.

In other words, there is no current financial crisis. So, what's with all the hand-wringing? Well, if you make pessimistic predictions about economic growth, immigration and wage inflation, projected revenues may not be enough to pay benefits. Social Security actuaries, for instance, project that growth will average only 1.6% after 2010, about half the rate we have enjoyed in the past century. But if the economy grows at anywhere near the levels that Bush's own budget experts project, the surplus, in effect, would never run out.

Most important, to the extent that there is a deficit, it could be covered by a variety of modest combinations of tax hikes and benefit cuts - each of them



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quite manageable.

A careful study by AARP estimates that 43% of the Social Security deficit projection would be met by raising the cap on taxable wages from \$90,000 to \$140,000; 38% would be covered until 2083 by raising to 70 the retirement age for full benefits; a quarter-percentage-point increase in the payroll tax for employees and employers would cover 24%; requiring state and local government workers to join would cover 9%. Yet another approach implicit in the President's program is to decelerate increases in benefits by raising them in line with prices, not wages.

This readjustment would eliminate the 75-year projected deficit of Social Security, but it would have a major impact on low-wage earners who depend almost entirely on Social Security, and it would reduce benefits for middle-income workers by as much as 25% over 30 years. It would thus preclude many seniors from enjoying the benefits of rising standards of living.

A solution here is to protect workers at the lower end of the income spectrum by retaining benefits according to wage rises for them but lowering benefits to price indexing for the higher levels. Or some mix of the two.

President Bush has a different answer to all of the above. In pursuit of his "ownership society," he wants to move Social Security toward "greater individual opportunity, risk and reward" by allowing individuals to carve themselves private investment accounts out of Social Security payroll taxes, much like a 401(k) plan. This raises a whole host of problems.

It discriminates against poorer workers because the lower your income, the less you have to invest and the smaller your return will be. The Bush plan offers nothing close to the financial security of the existing program. Then there's this: Are individual investors sophisticated enough to match the higher returns now being forecast? At least 10 studies analyzed by the Securities and Exchange Commission indicate a disturbing level of financial illiteracy. Only 12% of the investors studied could distinguish between a load and a no-load mutual fund; only 14% understood the difference between a growth stock and an income stock; only 38% knew that when interest rates rise, bond prices fall; almost half somehow believed that diversification guarantees that their portfolio would not suffer if the market dropped, and 40% thought that the trust fund's operating costs would not be deducted from their investment return.

Experience with 401(k) plans shows that many people fail to invest and to diversify sufficiently to maximize returns. Many make mistakes, not because they are stupid but because they live busy, complicated lives, focusing on work and family, and lack the time to become financial experts. Those 50% or more who are not in the stock market presumably have even less knowledge and experience.

Furthermore, historical stock-market returns are not a guide for future performance. If someone retires after the market dives, he or she could lose a good chunk of retirement savings. The market, after all, fell by 45% in real terms between 1968 and 1978 -- never mind the bust between 2000 and 2002. If millions of retirees suffered dramatic losses, there would be enormous pressure to come to their rescue. We would very likely end up privatizing gains

and socializing losses.

The macroeconomic consequences of privatization are equally significant. Privatization fails to address the long-term gap in the program's financial resources. It would make things worse because the government would have to borrow the money that otherwise would be paid into the system.

Of course, the idea of Bush's "ownership society" is to change the relationship of Americans to government so they look less to Washington than to themselves (and, just maybe, vote more Republican). No doubt some Americans could build savings and more wealth and have a nest egg for retirement. No doubt there is value in savings and self-reliance, planning ahead and increasing distance from the government. But there are other values in the very title of the program - Social Security. "Social" surely implies a contract to help manage poverty among the old and to know that our society provides a minimum income for all in the retirement years. And "security" means buffering the harshness and cruelty of the markets so the well-being of the elderly is not dependent on shrewd stock picks and hot mutual funds.

Privatization thus gets things upside down. Social Security was not meant to re-create the free market; it was intended to insure against the vagaries and cruelties of the market and to permit Americans to count on the promise that the next generation will take care of them in their old age.

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