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from the June 20, 2005 edition

Social Security reform: A way to manipulate the market

By Kerry Lynch

GREAT BARRINGTON, MASS. – One of the biggest potential dangers of the White House plan to create a private investment option as part of Social Security is the incentive it would create for the government to interfere with the markets.

Under the type of program favored by the White House and most free-market economists, a worker could channel a portion of his or her payroll tax into a personal investment account similar to an IRA or 401 (k) plan. The investment options probably would be limited to a small group of index funds, similar to those offered in the federal employees' 401(k)-style Thrift Savings Plan (TSP).

And therein lies the rub. Who would decide which funds are approved? Government officials would - and they'd do it by limiting investment options to a few index funds. It's not hard to envision special interests pressuring Congress or the White House to require the Social Security investment funds to exclude certain stocks- or to use inclusion of certain stocks as leverage to force companies to change their ways. For example: Suppose a fund held shares in a tobacco company, or in a company being sued for sex or race discrimination. Suppose the fund owned stock in a company that sells products made by sweatshops in China.

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Also politicians would have an even stronger incentive than they have now to use US fiscal and monetary policy to create a perpetual bull market and keep the economy and markets artificially booming. That's because the bigger personal accounts get before retirement, the smaller the traditional Social Security benefits would be - and the less it would cost the government.

And even the most sincere effort to limit political interference would, itself, require Washington to interfere in the market. Because limiting investment options to a few index funds would in effect channel hundreds of billions of dollars into a few thousand, or even a few hundred, companies, thereby excluding thousands of others.

Though proponents of private accounts focus on the benefits of letting individuals control their investments, it is hard to imagine how Washington would keep hands off when Social Security provides such a large and compelling target.

For proof, look no further than legislation introduced recently by House Government Reform Committee chairman Thomas M. Davis III (R) of Virginia and colleagues Chris Van Hollen Jr. (D) of Maryland, and Jon C. Porter (R) of Nevada. With backing from the National Association of Real Estate Investment Trusts, the legislation would require the Federal Retirement Thrift Investment Board (which oversees the federal employees' savings funds) to include a real estate investment (REIT) trust fund among the five investment options available to federal employees.

The issue isn't whether REITs - which have recently outperformed the S&P 500 Index - are sound investment vehicles. The issue is political meddling. After 20 years of existence, the Thrift Savings Plan now has approximately \$130 billion in assets. But if just 10 percent of the Social Security payroll taxes collected last year had been diverted into personal accounts, the total investment for that year alone would have been \$40 billion. (And 10 percent is less than most "privatization" advocates envision.)

Social Security would be a far more tempting target because of its importance and size.

Social Security was originally designed, in President Franklin D. Roosevelt's words, to "give some measure of protection to the average citizen and to his family against ... poverty-ridden old age." The program has drifted from that original goal. Changing it to a national investment plan would push it even further away.

• *Kerry Lynch is director of research at the American Institute for Economic Research.*

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