A Warning For Social Security "Reformers"

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While the administration is preparing its drive to replace part of Social Security with private investment accounts, an obscure government agency is planning to go to Congress to ask for a bail-out. The Pension Benefit Guarantee Corporation (PBGC), which guarantees private pension plans, just announced that its net liabilities are double earlier estimates, more than $23 billion.

"…it is imperative that Congress act expeditiously so that the problem doesn't spiral out of control," said PBGC executive director Bradley D. Belt. These net liabilities are likely to balloon to much higher levels if troubled airlines continue their slide into bankruptcy.

Are Social Security privatization and trouble at the PBGC related? You bet. The trouble at the PBGC illustrates the great risks involved in retirement planning, risks that have swamped enough private pension plans to require a Congressional bailout. Yet the Bush administration is proposing to wind down the only part of retirement income that is secure—guaranteed against the business cycle, inflation, and corporate malfeasance—and replace it with risky private accounts, with no guarantees at all.

When Social Security was introduced in 1935, it was understood that public pension benefits would never provide a comfortable retirement income. Private pensions and private saving would constitute the other two legs of the "three-legged stool." Nearly 70 years later, with average Social Security benefits at about $10,000 per year, Social Security can hardly be called generous.

Private pension plans still are essential to a decent retirement, but they increasingly are moving away from guaranteed benefits (and even these guarantees were subject to change) toward employers' contributions to employees' saving for retirement. Among the remaining "defined benefit plans," enough have gone belly up to create the crisis at the PBGC. Traditional private pension plans—at Pan American Airways, Bethlehem Steel and other failed companies—are sufficiently underfunded that Congress is being called in to bail them out.

Individual private accounts are no more secure than the pension accounts set up by companies to pay traditional retirement benefits. Some private accounts will crash and burn, just as some corporate accounts have proved inadequate. In fact, there is every reason to believe that individual private accounts will on average produce lower returns than professionally managed corporate pension funds.

The demise of Enron illustrates these risks. Not only were employees blindsided by the collapse of their high-flying employer, but a large group of them had accumulated unbalanced 401k individual retirement accounts, heavily invested in Enron. Their retirement accounts went up in smoke at the same time as they lost their jobs. Couples on the verge of retirement saw their private retirement accounts lose hundreds of thousands of dollars in days. All they had left was Social Security.

Even a well diversified retirement account cannot avoid the fluctuations that knock 20 or 30 percent, or more, off the value of the market every few decades. Anyone who had to postpone their retirement after the dotcom bubble burst in 2000 is still waiting for the market to recover.

The bankruptcy of the PBGC, with its anxious call for a Congressional bailout, should send a clear signal to the debate about Social Security: we still need social insurance to guarantee a minimum retirement income. Private accounts produce too many risks, too many surprises, for us to count on them as a replacement for Social Security guarantees.

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