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Commentary: Private Accounts: Right Idea, Wrong Time

Why a longtime advocate isn't backing Bush's plan

President George W. Bush's plan to privatize Social Security is as ill-considered as his "cakewalk" invasion of Iraq. This is a hard admission for an economist who has long beat the drums for Social Security privatization. What has happened to change my mind?

A privatization scheme launched early in President Ronald Reagan's first term would have had a 20-year financial market boom to underwrite the shift. The 1980s and 1990s were also periods of strong employment growth, which would have helped generate the payroll revenues needed to fund the transition. The U.S. had not amassed the massive trade deficits that now undermine its capacity to issue trillions of dollars in new debt, and it had not launched a costly war in the Middle East.

Strike One against Bush's plan is the inability of the weakening dollar to carry the debt burden required to finance the transition to privatization. Foreigners are drowning in dollars. With the U.S. economy in relative decline, they have no appetite for additional trillions of dollars. The greenback has weakened so much that it's on the verge of losing its status as a reserve currency.

Strike Two is the lack of domestic savings that would fund the shift. The U.S. personal savings rate is practically nonexistent, and the government budget is awash in red ink. Offshore production, job outsourcing, and the proliferation of H-1b and L-1 work visas for foreign professionals have brought a halt to the growth in the high-value-added, high-productivity jobs that permits household saving.

During the past four years the U.S. experienced a net loss of 760,000 private-sector jobs instead of a normal gain of millions of new jobs. Moreover, employment has shifted away from jobs in export- and import-competitive goods and services sectors. The Bureau of Labor Statistics payroll data show that the economy has been able to create jobs (although not net new jobs) only in lower-paid, domestic services that cannot be moved abroad. The BLS predicts that the vast majority of new American jobs in the next 10 years will not require a university education.

The trend toward lower-paid jobs means lower incomes, especially as the weak dollar begins to hurt domestic prices. Some 70% of Wal-Mart Stores Inc.'s ([WMT](#)) goods come from China. When China is no longer able to maintain the unrealistic undervaluation of its currency, Wal-Mart's prices will rise. A population that is subject to these pressures -- and loaded up with debt -- is not a high-saving society.

Strike Three against Bush's plan is that the drive for revenues will likely result in raising the "cap" on withheld wages and salaries above the current level of \$90,000. Assuming that the Social Security tax rate remains the same -- and leaving aside the fact that the 50% share of payroll taxes paid by employers are deductible -- raising the cap will translate into a marginal tax rate increase of 12.4 percentage points on all income up to the new cap.

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Consider, for example, a person earning \$500,000 a year. Removing the cap entirely would extract an additional \$50,840 annually in Social Security tax. Even simply lifting the cap would result in a hefty hike. A cap of \$110,000, for example, would boost taxes on everyone earning that sum by \$2,480. Unless the benefits are increased proportionally, the scheme is nothing but a backdoor marginal tax rate hike that makes a mockery of the President's tax rate reductions.

Social Security can be fixed without raising taxes or saddling the dollar with a debt burden it cannot sustain. In 1981, Deputy Assistant Treasury Secretary Stephen J. Entin produced a plan that eliminated the Social Security shortfall by changing the initial benefit formula from wage indexing to price indexing. Real benefits would still rise, though more slowly. If U.S. wages continue to outpace prices, the Treasury's 1981 plan would work today. But if the developments discussed above cause prices to outpace wages, leaving the benefit formula unchanged would correct the problem. In other words, indexing to whichever is growing at a slower pace -- wages or prices -- would be a surefire solution.

The Treasury's plan was preempted by then-Budget Director David Stockman and current Federal Reserve Chairman Alan Greenspan, who used the Social Security Commission to accelerate Social Security tax increases for the purpose of reducing federal budget deficits. Let's hope the current Social Security "fix" doesn't become just another revenue grab.

By Paul Craig Roberts

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