

## *The Social Security Reform Hoax*

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A few weeks ago, I wrote a column about the retirement savings conundrum in our great nation. The basic point being that if everybody suddenly started saving enough for a fat and happy retirement, the economy would plunge into a decades-long recession. The solution is for everyone to delay retirement, or for at least some of us to out-save everyone else.

Since this is an election year, I feel free to talk politics. To narrow that down a little, I'll talk about one small part of the winning candidate's platform. The Bush Administration has proposed that working people be permitted to voluntarily divert a large portion of their Social Security contributions into an account similar to an IRA or 401(k), where it can be invested in stocks and bonds.

While perusing my morning newspaper, I sprayed a mouthful of coffee across the kitchen when I read that paper's description of why the Bush proposal would be a good thing. Perhaps I should have written a letter to the editor, but they probably don't care what I think. Maybe you do care.

The argument in favor of this plan goes along these lines: According to the proponents of the diversion plan, the Social Security system has a fatal flaw. The flaw is that its ability to pay benefits to retirees will depend on ever increasing numbers of young workers who can pay the taxes from which such benefits are paid.

Here's how the paper's editorial page put it: "Social Security as it exists today is, in fact, a Ponzi scheme that relies on an unending flow of new workers in large numbers to cover the retirement checks of earlier generations."

Heck, I guess if you put it like that, then sure, Social Security might be likened to a Ponzi scheme. The only way to pay anything out is if new participants come into the system.

But, let's stop for a moment and examine the alternative proposed by the Bushies. Workers will instead accumulate nice large portfolios of stocks and bonds. During the years that they own (and live on) these investments, they will expect them to rise in value and pay dividends and interest. It then follows that we should consider what sorts of economic conditions will result in rising stock values and healthy dividend and interest payments. The obvious answer is that the economy *has to grow*. No growth; no stock returns.

You might not realize it, but more than two-thirds of our economy's real economic growth is due to population growth. While we might like to think that the economy grows because we are all such dynamic hard

working innovators, the truth is that the great bulk of our economic growth happens because children are born and people move here from other nations. As Woody Allen so famously said, "Eighty percent of life is just showing up." *Most economic growth is created by people just showing up.* A recurring quip in my graduate school economics program was: *Want to grow the economy? Throw people at it.*

So, if the success of our stock and bond portfolios most certainly depends on new people constantly entering the system, what makes an investment portfolio different from Social Security?

Further, we must realize that the retirees under the proposed plan will need to sell some stocks and bonds eventually. They don't accept General Electric stock down at the supermarket. You have to sell the stock and buy groceries with cash.

If you own a big portfolio of stocks and bonds in your retirement years, who are you going to sell them to? That's right – younger workers who are still saving for retirement and need to buy stocks and bonds. In other words, those very same people that the Bush Administration thinks constitute the key ingredient to a Ponzi scheme!

We must accept the fact that the only way our trust accounts and IRAs and 401(k)s are going to be worth anything in our retirement is if there is a steady stream of new workers coming along behind us. Yes, this is the exact same conundrum we face with the Social Security system, and I encourage you to think more deeply about the problem than policy makers and newspaper editors have.

In truth, whether our retirement paychecks come from taxes paid by younger workers, or from companies that make money selling goods to younger workers, or from stocks sold to younger workers, we still have a *population demographics problem*. Shifting the savings and payment mechanism from Social Security to stocks and bonds is just so much moving of deck chairs around on the Titanic. The ship is still sinking, but we can pretend for a moment (or for an election cycle) to have dealt with the problem.

*And the band played on...*