THE FAKE CRISIS

Two years ago, President Bush's big scam was weapons of mass destru Now it's Social Security. Economist Paul Krugman explains the lates

By Eric Bates

TO HEAR GEORGE Bush tell it, Social Security is about to go broke. Since his re-election, the president has launched a full-scale campaign to convince the public that the retirement system will run out of money starting in 2018. "The system goes into the red," Bush told reporters on December 20th at a rare press conference. "Many times, legislative bodies will not react unless the crisis is apparent, crisis is upon them. I believe that crisis is." Social Security, he concluded, "can't sustain that which has been promised to the workers."

To save Social Security, Bush wants to destroy it – replacing government-guaranteed retirement benefits with private accounts that will be subject to the whims of the stock market. It's an expensive plan. Allowing workers to divert even a small portion of their payroll taxes into private investments, as Bush is proposing, would require the government to borrow at least $2 trillion to make up the immediate shortfall. It's also completely unnecessary, according to Paul Krugman, a prize-winning professor of economics at Princeton University. In a blistering series of columns in the *New York Times*, Krugman has marshaled the economic data to show that Social Security is not only solvent, it's in much better financial shape than the rest of the federal government. "The people who hustled America into a tax cut to eliminate an imaginary budget surplus and a war to eliminate imaginary weapons," Krugman wrote recently, "are now trying another bum's rush."

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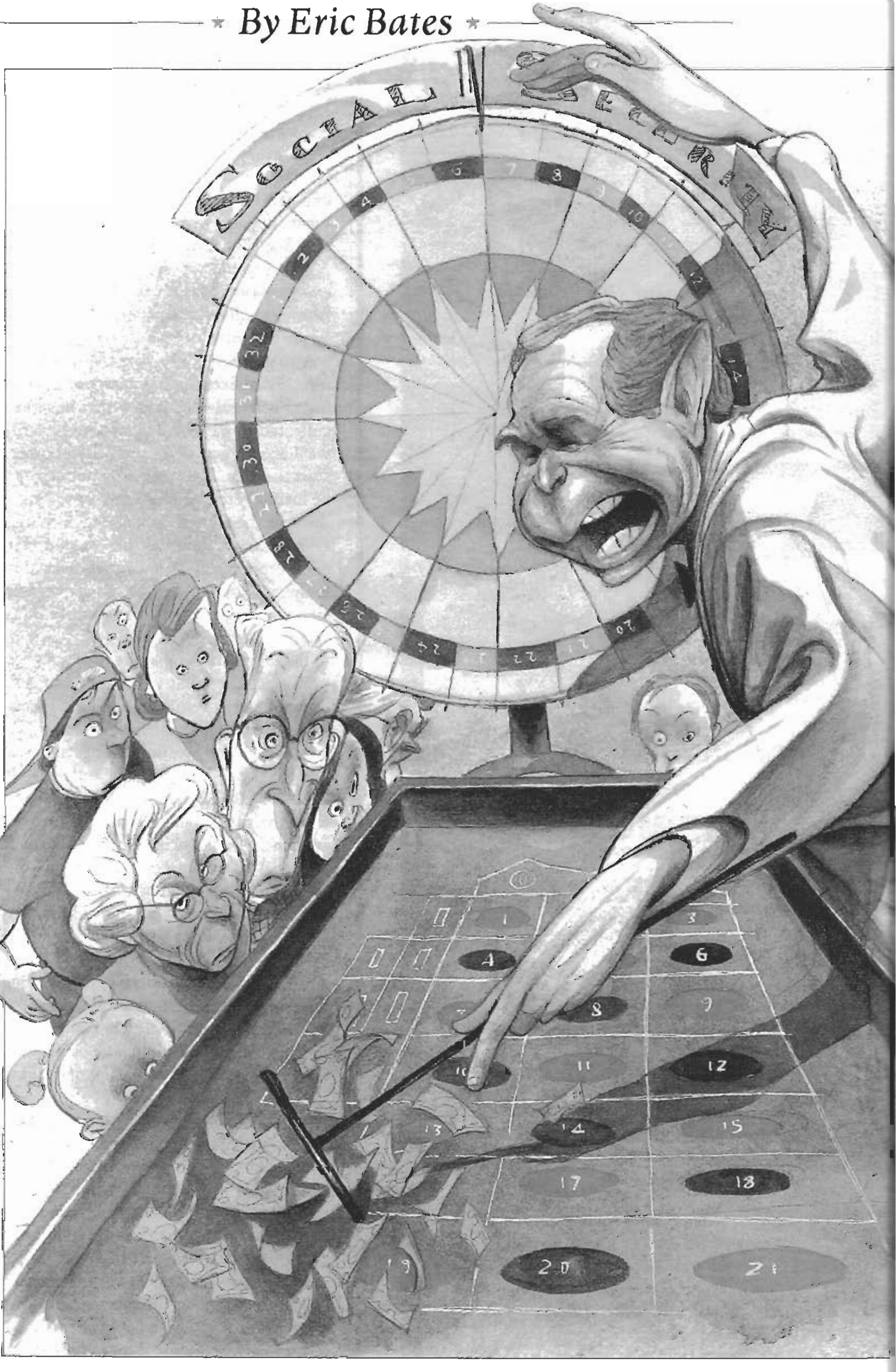

ILLUSTRATION BY STEVE BRODNER

Bush at an economic summit he staged in December to tout his plan to privatize Social Security.

MATTHEW CAVANAUGH/EPA/AP PHOTO

At his tree-shaded home in Princeton, New Jersey, Krugman took a break from working on a new economics textbook to explain why the crisis is phony – and what's wrong with Bush's plan "to convert Social Security into a giant 401(k)."

What would you say to college students and young workers who are convinced they'll never see a dime of the money they put into Social Security?

You've been sold a scare story. Right now Social Security has a large and growing trust fund – a surplus that has been collected to pay for the surge in benefits we'll experience when the baby boomers start to retire. If you're twenty now, you'll be hitting retirement around 2052. That's the year the Congressional Budget Office says the trust fund will run out. In fact, many economists say it may never run out. If the economy continues to grow at an average rate, the trust fund could quite possibly last forever.

But what happens if it doesn't?

Even if the trust fund does run out, Social Security will still be able to pay eighty percent of promised benefits. The actual shortfall would be a pretty small part of the federal budget, quite easily made up from other sources. Once the whole baby-boomer generation is into the retirement pool, Social Security's share of the gross domestic product will only increase by about two percent. Well, President Bush's tax cuts are more than two percent of GDP – and they're happening right now, not fifty years from now. So the idea that there's this Social Security thing that is a huge problem is just wrong.

But if the trust fund does run out, the government would have to raise taxes or cut benefits, or some combination of both, to keep Social Security solvent.

Yes, if the trust fund is ever depleted, then something will have to be done. But you need to have some perspective on the seriousness of this whole thing. On the day the trust fund is exhausted, Social Security revenue will cover about eighty percent of the cost of benefits. Right now – today – if you look at the U.S. government outside of Social Security, revenue covers only about sixty-eight percent of total government spending. So on the day the trust fund is exhausted, forty-seven years from now, Social Security will be in better financial shape than the rest of the U.S. government is today.

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So if there's no crisis in Social Security, why is President Bush pushing so hard to privatize it?

It's politics. Since the days of Barry Goldwater, the Republican right has really wanted to dismantle Social Security. And now they have a degree of political dominance that lets them push it to the top of the agenda – even though no rational analysis of the actual problems facing the U.S. government would say that it belongs there.

Why do they want to dismantle it?

It's hard to understand why anyone would want to return us to the days before the New Deal, when millions of elderly people lived in poverty. But if you really dislike the notion that the government provides a safety net for the poor, then Social Security is the prime target. The U.S. government is a big insurance company, with a side business in national security. Social Security is the biggest social-insurance program that we have. It's been highly successful, and it's extremely popular. It's one of the things that makes people feel somewhat good about government – and so, therefore, it must go.

And some people stand to profit from abolishing it. Wall Street poured a lot of money into both of Bush's campaigns, hoping he will divert Social Security into the stock market.

That's a factor, but I don't think it's the reason behind it. Attacking Social Security is a lot like attacking Iraq – just because a lot of people stood to get lucrative contracts from it, that doesn't mean that's why they did it. If you privatize Social Security, there's going to be a tremendous amount of income for the mutual-fund industry. That's one reason there is a constituency for this on Wall Street. And that's one of the important reasons why this is really gonna work very badly.

What do you mean? Those who are pushing privatization say that our financial markets are one of our greatest strengths – that private investment will work better in the long run than government-managed accounts with lower rates of return.

There are two problems with that. First, the fees charged on private accounts will be a significant drain on returns. In a typical portfolio, we're probably looking at a return of four percent. But fees are likely to take at least one percent, like they do in Britain. So now we're down to a return of three percent or less on private accounts. And since Bush wants to borrow $2 trillion to pay for the transition, we're talking about borrowing at interest rates of three percent to establish private accounts that will yield three percent – with a lot of additional risk. So it's a lose-lose proposition, except for the mutual-fund industry.

The second problem with the market is that some people – probably many people – will end up getting much less than they would have under the current system, depending on which funds they pick and how the market does. A lot of people will hit age sixty-five with very little in their private account – and that means a big return of poverty among the elderly, which is exactly what's happening in Britain right now. As a result, the government will have to step back in and rescue people. We'll have more suffering and bigger bills. People will ask: Where did all that money go? The answer will be: It basically went into mutual-fund fees.

But what if stocks do well? Isn't it possible that privatization would work?

The only possible way that stock returns can be high enough to make privatization work is if the U.S. economy grows at three to four percent a year for the next fifty years. But Social Security's own trustees expect the economy's growth rate to slow to 1.8 percent. If that happens – if their own assumptions are correct – then privatization would be a disaster. And if that doesn't happen – if the economy continues to grow at a steady rate – then the trust fund is good for the rest of the century, and we don't need privatization.

In selling the idea that there's a crisis, Bush has a lot of powerful words on his side: "choice," "freedom," "ownership society." What words do you have to counter his sales job?

Scam. Three-card monte. I've been thinking a lot about flying pigs. The privateers are claiming that you can have something for nothing. They're basically saying, "Let's assume that pigs can fly." And when you say, "You know, it's not good to assume that pigs can fly," they respond by saying, "What's wrong with you? Don't you understand the enormous advantage of flying pigs?"

The only reason they talk about how wonderful an ownership society would be is because we managed to win the battle over the word *privatization*. The Cato Institute – which is the intellectual headquarters for all this stuff – founded something in 1995 called the Project on Social Security Privatization. But focus groups don't like that word, so in 2002 they changed the name to the Project on Social Security Choice. They didn't announce a name change – they just went back and scrubbed their Web site, so there's no indication that it was ever called "privatization."

If there's no crisis in Social Security, why aren't the Democrats saying that more clearly and forcefully?

There's a lot of timidity. They're desperately afraid of seeming like "Oh, well – we have our heads in the sand, and we're not active." I would like to see them step up to the plate and say that these claims that we're going to have a crisis sometime in the next fifteen years is just garbage. Bush is handing them an opportunity by making this the centerpiece of his agenda. Democrats should treat privatizing Social Security the way Republicans treated Clinton's health-care plan – they should say, "This is a disaster, and we will stand against it." Social Security is simply not the biggest problem facing the government today.

What is?

If you really want to get scared about something that can happen between now and 2052, you should talk about Medicare and Medicaid. The entire system of private health insurance is gradually collapsing. And as the share of people getting medical insurance through their employers continues to decline, the number of people who have to rely on the government for health insurance keeps going up. At the same time, medical costs keep on rising, because doctors keep on figuring out new stuff to do – procedures that didn't exist ten or twenty years ago.

So what needs to be done to shore up Medicare?

In our system, we have huge administrative costs – which are mostly driven by insurance companies spending huge amounts of money trying to avoid covering people. Our health-care costs are eighty percent higher than those in other advanced countries. The best way to contain those costs is to go to a single-payer system, one in which the government insures everyone. That would probably cut the cost of health care by at least twenty-five percent.

But there's no way that will happen under Bush.

He actually wants to do the opposite. If he manages to privatize Social Security, he'll try to privatize Medicare next. He'll try to strip away guaranteed health care and turn it into some kind of system of individual health accounts. The right says that what we need is more choice, more competition. But every piece of evidence suggests that health care is an area in which privatization actually raises costs. If they succeed at dismantling both Social Security and Medicare, then you're pretty much back, on domestic policy, to the days of Warren Harding – which is exactly where they want to go.

BY THE NUMBERS

COOKING THE BOOKS

President Bush is proving to be a master of creative accounting. During the campaign last year, he promised voters again and again that he would cut America's deficit in half within five years. But to reach that goal, he's using a phony number. Instead of cutting the actual deficit, which stands at $413 billion, Bush says he will cut the shortfall of $521 billion he erroneously projected last year. In other words, in the president's mind, he has already cut $108 billion from a deficit that never existed. "This is an analysis that would get an F in any kind of economics class," says Stanley Collender, a respected nonpartisan analyst and author of *The Guide to the Federal Budget*.

Using a fake number is not the only way Bush is cooking the government's books. To make it even easier to reach his deficit-cutting goal, the president is simply leaving his biggest and most costly initiatives out of the budget entirely. Here are five major items the administration isn't bothering to include in its proposed spending plan:

- Privatizing Social Security: **$2 trillion**
- Making Bush's tax cuts for the wealthiest Americans permanent: **$1 trillion**
- The new Medicare prescription-drug program: **$500 billion**
- Additional tax breaks for high-wage earners: **$400 million**
- The wars in Iraq and Afghanistan: **$100 billion**

How can the president omit such budget busters from the budget? Social Security and Medicare are handled in separate funds; the wars are considered "supplemental appropriations"; the tax cuts won't take effect until after Bush leaves office. But such budget shenanigans obscure the true size of the deficit, which Wall Street analysts now predict will total an astounding $5 trillion over the next decade. "I'm calling this the un-budget, because it excludes all of Bush's major policy efforts," says Collender. "The way they approach it, it's going to be someone else's mess to clean up." DAVID SWANSON