

How Can Stocks Help Social Security?

THE DEBATE OVER LETTING WORKERS USE SOME of their Social Security payroll taxes to buy stocks has concentrated on the cost of converting from the pay-as-you-go system to an investment system, but the most important question is being avoided: How can stocks pay retirees the dependable cash incomes they'll need?

Advocates of the change don't explain that stocks provide cash only when they pay dividends or when they're sold. It would be foolhardy to allow payroll taxes to be used to buy stocks until solid analyses show how dividends and sales can provide enough cash to support baby boomers and younger workers when they retire.

Advocates of the change say that since 1925, stocks have provided larger total returns than other types of investments. But they don't say that before 1982, more than half of the returns came from dividends. In 2003, stocks paid \$431 billion in dividends while Social Security paid \$406 billion in Old Age and Survivors Insurance benefits and \$73 billion in Disability Insurance benefits. If the program had owned every dividend-paying stock in the country, it would have received 10 percent less in dividends than it paid out.

Social Security can never own all of the country's listed stocks, if only because pension and other retirement plans already own more than half of the domestically-owned stocks that are traded on U.S. markets. As boomers retire, its payments will grow faster than dividends for decades. Regardless of whether stocks are owned by Social Security or other retirement plans, dividends cannot be expected to provide more than a small portion of the cash retirees will need.

So retirement plans will have to sell most of their stocks for large profits or gains. That will require buyers who are willing to provide the cash. Most U.S. stock and mutual fund buyers are workers who are in their peak



earning years, from 40 through 64—the same workers who pay most of the Social Security taxes. The advocates haven't explained why those workers would rather buy high-priced stocks (and transfer some of their income to retirees) than pay Social Security taxes. There has been no explanation because, except for the additional risks, there's no basic difference.

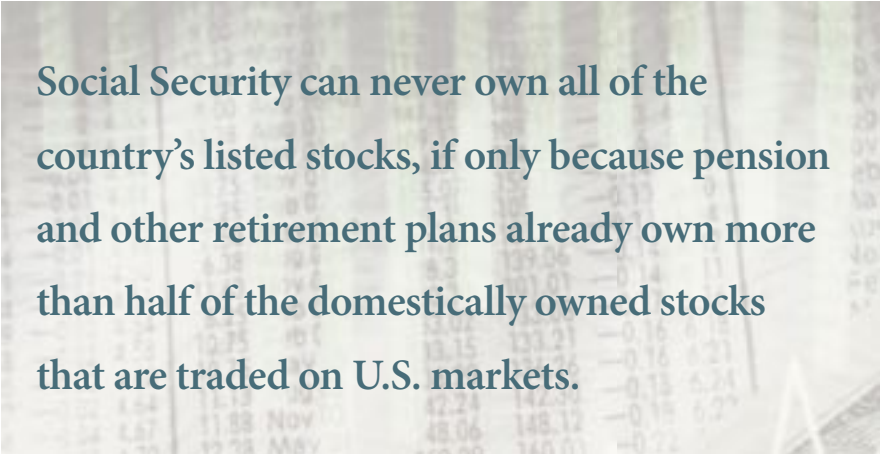
Substituting stocks for the present Social Security system won't just affect boomers; it will also hurt younger workers who don't expect the current program to do much for them. For stocks to keep paying cash incomes to retirees, each generation of workers will have to pay higher prices for the stocks than the retirees paid for them. Unless someone can explain why prices will keep growing several times faster than the

economy as the stocks are transferred from generation to generation, the idea is simply a pyramid scheme that must eventually fail.

Those who advocate using stocks to relieve the pressure on Social Security claim that the money will go to companies to use for creating new products or services and providing jobs, but that's wrong. Most established companies pay for expansion with cash they earn from operations and by borrowing. Federal Reserve data show that between 1982 and 2003, companies removed slightly more stock from the market than they issued. The influx of retirement savings helped feed the recent bull market, but the money didn't go to companies; it went to a few individuals.

Analyzing the data shows that those who sold most of the stock that retirement plans bought must have been corporate insiders who had received huge blocks of shares at little or no cost and sold them for huge profits. Bill Gates, whom *Forbes* says is the richest person in the world, is the prime example. When Microsoft went public, he retained 45 percent of the stock. He's reported to have sold 2 billion shares and to still own 1.2 billion

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shares, which he's selling at the rate of 80 million shares a year. Nearly all large pension plans and mutual funds own Microsoft stock; statistically, more than one-fifth of the shares they own were sold into the market by Gates himself.

In addition to Gates, before the market fell in 2000, there were an estimated 10,000 "Microsoft millionaires," or employees of the company who had received much of their compensation in stock or options and, became wealthy when retirement plans drove up the price of their stock. The 278 American billionaires listed by *Forbes* in 2004 own the equivalent of just under one-sixth of all the stocks owned by households.

Retirement plan purchases helped to set the market prices of their shares. When retirement plans bought some of their shares, the plans transferred money directly from workers to the insiders. Retirement plans have been a major factor in widening the wealth gap between the middle class and the richest few. Using stocks to help Social Security would continue to transfer the earnings of middle-class workers to the wealthy.

Trying to use stocks to pay retirement incomes to boomers is already an unprecedented experiment. In the past, most wealth was passed from older people down to their younger heirs. This experiment is an attempt to reverse that flow by using stocks to pass wealth from younger people (who are still working) up to retirees. This can be successful over the long run only if successive genera-

tions of workers are willing to pay ever higher prices to buy retirees' stocks.

The relationship between boomers' retirement plans and corporate insiders has been symbiotic. The plans wanted the insiders' stocks, and the insiders wanted the boomers' cash. In the future, the relationship will change as boomers' retirement plans switch from buying to selling and compete with insiders for the dwindling number of worker/buyers. That can depress stock prices for years as the supply offered for sale expands and demand for them shrinks. Unless workers decide to pay ever higher prices for retirees' stocks while insiders are also selling, retired boomers won't get the cash they've been told to expect. The result could be a sustained bear market that could lead to a depression. And as today, little of the workers' retirement savings would go to companies to be used for growing and providing more jobs.

Unless this explanation is wrong, allowing Social Security taxes to be diverted into stocks would be a major mistake. Instead, Social Security should be continued as a simple pass-through program because it doesn't involve the risk of severe stock market losses. Advocates of allowing the diversion should have the burden of proof to explain the mechanics of how dividends and stock sales can provide cash incomes to retirees.

This is not a partisan or ideological issue; it's one of system feasibility. If millions of workers are allowed to channel their Social Security taxes into stocks that

fail to provide the cash retirees will need, all Americans will be hurt regardless of party. Senators and representatives who want to avoid a serious mistake should ask the Government Accountability Office to answer four questions before anyone considers changing the system:

■ When retirement plans buy stocks on secondary markets, where does the money go?

■ Can the stocks in retirement plans pay retirement incomes without having to be sold? If not ...

■ Who will be the primary buyers, and what evidence is there that they'll pay adequate prices to provide baby boomers' retirement incomes?

■ Can buying and then selling stocks make retirement savings grow faster than the economy for multiple generations, or is it a pyramid scheme doomed to failure?

Advocates of using stocks to help Social Security, as well as leaders of the financial services industry, should have to answer these questions, too. If there isn't a sound explanation of how these proposals can work, they shouldn't be adopted. Adopting them would increase the danger that the experiment of reversing the historic flow of wealth between generations will fail and weaken the safety net that millions of people will need if it does fail.

Instead of looking for an easy answer that doesn't appear to exist, Americans should concentrate on the opportunities and challenges that population aging will bring. By the end of 2030, about a quarter of America's adults will be over 65. To sustain their standard of living and meet the added expenses of old age, they'll need something like a quarter of the country's personal income.

Neither Social Security nor stocks can provide anything close to that amount. The country cannot avoid the question of whether it will provide appropriate jobs for its elderly who can work and adequate income for those who retire, or just let each successive generation slide into despair. ●