Thanks to Andrew Sullivan for posting Michael Kinsleys challenge to
President Bush's desire to privatize Social Security. I personally couldnt think of anything more threatening to our future, or more likely to cause economic calamity of the highest order.

Before I post Mr Kinsleys challenge, let me define my fear, and some anecdotal evidence to support that fear.

The Presidents plan in simplistic terms, is to allow all of us taxpayers to take a small portion of our social security contributions and invest that money as we see fit. The premise is that by investing in things that the Social Security Fund cant , each of us can earn greater returns and better protect our financial future.

Wrong.

Of course, with the search for greater returns, comes greater risk. Now I always thought that the Social Security program itself was designed to protect us from ourselves. That those of us who might be able to save, didn't save enough to protect us at retirement, and those of us who were never in a position to save, had a fallback that we as a nation all contributed to.

Along comes the Presidents proposal which kind of flips the logic. Now the admission is no longer that we as individuals can no longer save money, its that we as a country can no longer save money. Our politicianswho might have been able to save moneyin better times, didnt. As a result, as a country it appears that we will be unable to meet our future obligations for Social Security.

Rather than shaving off all the pork we feed our politicians, and beyond in order to create funding to meet our obligation, the President has decided to relinquish part of the obligation back to us, in hopes that each of us make more than the government could, and pay for more of our own, and our childrens future. To put it another way, keep some of your social security contributions and play the financial markets lottery.

In his challenge, Mr Kinsley correctly describes why it wont work. Let me give you two examples why its even worse than he describes.

1. Our Pension System

In the first example, as described so well by the NY Times, when companies were given the chance to make investments to meet their obligations to their pensioners, they were unable to do so. They had the option of taking on more risk, or playing it safe. They took on the risk and lost. True, there was the inherent use of pension accounting to scam wall street on earnings, but when it was all saidand done, when corporations took on the job of investing for the financial security their retirees, they were unable to do so. They are now turningto the government funding of The Pensions Benefit Guaranty Corp with the expectation of being bailed out.

If the experts that run our pension system had the expectation of financial protection bythe government if they failed, do we really think that all of us wont have the same expectation ? Does anyone really believe that the politicians later in this century wont latch on to "protect the unfortunate who fell prey to former President Bushs' misguided Social Security bailout ?" as a means of buying votes ? And each and every one of us knows it and will think it when we make our choice of "investments". Why not go for the jackpotif you know thatwhen you hit 70 you will be reimbursed?

2. The First Command Financial Scandal

What our President fails to realize is that we wont choose where we invest that money.

We will be marketed to, and sold financial products by companies who want that money. Buy media and brokeragestocks if this change happens. We will be inundated with more dumbass commercials about how this broker from this firm and that firm wants to help secure our future. Translated, they know we are suckers with the money burning a hole in our pockets and they are going to make a fortune in commissions on us. There will be so many scams there wont be enough pages in the Wall Street Journal to cover them.

In the First Command scandal, our government couldnt prevent thousands and thousands of military personnel from being sold an investment vehicle that took HALF their first year contribution and paid it to First Financial in commissions !. **Not only is it obscene in principal, but financially, that first year money will grow the most from compounding of whatever interest or gains that might occur. So they robbed the people who we entrust to protect our country TWICE. Personally, I think the principals at that company deserve to be in jail for a long, long time. Instead the were fined $12mm dollars. Whoever at the SEC or NASD settled for those fines is gutless, spineless and hasabsolutely no conscious. Hopefully its still possible for criminal charges to be filed against those slime and someone will step in and do so.**

Those in the military who allowed them to walk in the door and ripoff our servicepeople deserve punishment as well. No onein command should be that stupid.

IF privatization occurs, commissions, marketing fees and every other service and corporate fee tht can be invented are going to be squeezed from us. The last time I looked, I didnt pay commission on my social security contribution. I didnt pay asset management fees. I didnt pay for commercials of brokers and their clients staring lovingly at each other telling me the beauty of investing in oil futures.

Here is another way to look at how bad it will be.

In absolute dollars our social security contributions are not that high. The percentageavailable back to us, far smaller. So we wont be able to buy that much of whatever financial product we are being sold. So our commission per transaction will be high. The highest of any customer most likely.Our commissions and fees as a percentage of our savings will be high. Ten bucks a trade. 1 or 2 percent asset management fee. Its real money.

We will pay a lot and the actual amount of money that shows up on your statement is going to be a lot less than what it would have been if you just let the government keep it ! Your money wont have to earn more than the treasuries the government buys. You are going to have to be such a wise investory, that you have to earn more than treasuries after commissions and fees eat up 2, 3, 4 or more percent. Face it, you probably are going to lose money on that account compared to what the government could have gotten !

Of course your brokerage or fund wont tell you that. But thats a minor detail.

Lets face the facts. Our military couldnt prevent its soldiers from scams. Our soldiers couldnt protect themselves. Our pensioners couldnt trust their former employers from playing to wall street and taking more than reasonable risk, knowing that they could be bailed out.

What makes us think its going to be any different for most of us ? Sure, some of us will use the money and get some better returns, but we are already making better use of our savings and probably need the opportunity to invest our social security the least.

My bet is thatthe people who need the money the most, will take the greatest chances and will be sucked dry the fastest. Why wouldnt they take more chances? Its found money. They have every reasonable expectation that the government will bail them out if they dont strike it rich.

Here is Michael Kinsleys challenge. Read it. Email it and fax it to your senator and congressman. Forward copies to friends. Its your family’s future at stake

A BLEG FROM KINSLEY: My old boss and friend, Mike Kinsley, now running the editorial pages at the Los Angeles Times, poses the following conundrum, which he invites any of you to refute. Yep, he’s a big media guy turning to blogs for an answer. Write responses to him at michael.kinsley@latimes.com. Here’s his argument:

> My contention: Social Security privatization is not just unlikely to succeed, for various reasons that are subject to discussion. It is mathematically certain to fail. Discussion is pointless.
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> The usual case against privatization is that (1) millions of inexperienced investors may end up worse off, and (2) stocks don’t necessarily do better than bonds over the long-run, as proponents assume.But privatization won’t work for a better reason: it can’t possibly work, even in theory. The logic is not very complicated.
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> 1. To “work,” privatization must generate more money for retirees than current arrangements. This bonus is supposed to be extra money in retirees’ pockets and/or it is supposed to make up for a reduction in promised benefits, thus helping to close the looming revenue gap.
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> 2. Where does this bonus come from? There are only two possibilities: from greater economic growth, or from other people.
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> 3. Greater economic growth requires either more capital to invest, or smarter investment of the same amount of capital. Privatization will not lead to either of these.
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> a) If nothing else in the federal budget changes, every dollar deflected from the federal treasury into private social security accounts must be replaced by a dollar that the government raises in private markets. So the total pool of capital available for private investment remains the same.
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> b) The only change in decision-making about capital investment is that the decisions about some fraction of the capital stock will be made by people with little or no financial experience. Maybe this will not be the disaster that some critics predict. But there is no reason to think that it will actually increase the overall return on capital.
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> 4. If the economy doesn’t produce more than it otherwise would, the Social Security privatization bonus must come from other investors, in the form of a lower return.
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> a) This is in fact the implicit assumption behind the notion of putting Social Security money into stocks, instead of government bonds, because stocks have a better long-term return. The bonus will come from those saps who sell the stocks and buy the bonds.
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> b) In other words, privatization means betting the nation’s most important social program on a theory that cannot be true unless many people are convinced that it’s false.
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> c) Even if the theory is true, initially, privatization will make it false. The money newly available for private investment will bid up the price of (and thus lower the return on) stocks, while the government will need to raise the interest on bonds in order to attract replacement money.

d) In short, there is no way other investors can be tricked or induced into financing a higher return on Social Security.

5. If the privatization bonus cannot come from the existing economy, and cannot come from growth, it cannot exist. And therefore, privatization cannot work.

Q.E.D.

So Whats the solution ? First, we cant just try to fixSocial Security as an isolated program. We need to somehow change the culture of DC to one that respects fiscal sanity. We give our politicians license to “go out and get money” for projects that selfishly benefit us. We want that money for the insect museum down the street, or the new highway to the undeveloped part of town, or for whatever pet project buys jobs and votes. We have to change the culture of allowing our votes to be purchased with gifts. Until then, the only way to pay for our future is by increasing the risk we are forced to accept hoping it “all works itself out in the end”. At some point we will realize the hard way , that it doesnt.