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The New York Times ON THE WEB

July 22, 2002

The Binge Mentality in the Federal Budget

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BERKELEY, Calif.
We read in the news of the plight of older Americans as their nest eggs, invested in the stock market, have dwindled. Some can no longer afford to retire as planned; others are going back to work.

The stock market binge of the late 1990's, with its dreams of double-digit gains as far as the eye could see, was based on illusion, not reality. Now we know it. Irrational exuberance fed the bubble. Accounting tricks that inflated reported corporate earnings reinforced investor optimism. Insiders reaped huge gains; investors and employees saw their savings tank.

Another equally pernicious set of illusions — created by the same binge mentality — surrounds the federal budget, but has so far received less public notice because the negative effects have not yet surfaced. The budget binge is supported by the same kinds of unrealistic projections of future revenues, low-balling of spending and obfuscatory accounting that are now the focus of the Wall Street scandals. But the impact in this arena could prove even more enduring than the current problems on Wall Street. Those counting on Social Security for their retirement, along with future taxpayers, in due course will be left high and dry.

The perpetrators of the budget binge — President Bush and Congress — are sacrificing the public's long-term welfare for their own short-term political gains. In the case of Enron, the company's long-run stability was sacrificed for inflated stock prices in the short run. In the case of the federal budget, the health of Social Security and other programs is being sacrificed for unaffordable tax cuts. The motivation is the same: the decision makers don't believe they should be accountable for the long-run problems. Kenneth Lay walked away from Enron with millions. And the president and most lawmakers in Congress will be gone from office before the effects of the budget policies are fully felt.

Americans are told that we can have it all: more defense and more education; more homeland security and more agricultural subsidies; and a Medicare prescription drug benefit, in addition to last year's multi-trillion dollar tax cut. On top of all this, we're told that it's possible to fix Social Security — which is expected to exhaust its trust fund in 2041 if no action is taken.

These promises, of course, did not add up even in official budget projections, which unrealistically assumed no growth at all in inflation-adjusted discretionary spending, no relief for the 33 million taxpayers who, in the absence of a remedy, will unexpectedly face an alternative minimum tax, and the expiration without renewal of popular business tax incentives like the research tax credit. None of this could be sustained in reality. But the problem is even worse than merely having too little in federal revenues to do what politicians promised voters. The deeper problem is that the wayward budget takes off the table the resources that are needed to reform Social Security if we are to avoid politically unacceptable benefit cuts.

In his campaign, George W. Bush promised that Social Security could be repaired painlessly, by allowing younger workers to divert a portion of their Social Security payroll tax into individual accounts. Since the stock market has historically offered higher returns than government bonds and substantially higher returns than Social Security, he suggested that such new-found investment freedom would repair the finances of the retirement system. With the fall in the stock market we now see that a secure, defined-benefit pension has its merits after all. Imagine the political pressures for bailouts in the face of the current stock market decline if Social Security included individual accounts!

Even absent the falling stock market, privatization of Social Security has a fatal flaw: it can only be achieved at huge budgetary cost. Under the current system, the younger generation's payroll taxes pay the older generation's benefits. If Social Security is privatized, so that the younger generation diverts part of its taxes into individual accounts, then the government must finance (at enormous cost) the retirement of the older generation. It's like a family that hands down its clothes from one brother to the next: if somewhere along the way a brother gets to keep his clothes, the family has to head to the mall.

The price tag for the missing generation of clothes was disclosed in December, but without the emphasis it deserved, in the report of the President's Commission to Strengthen Social Security. This commission was supposed to devise a scheme of individual accounts without jeopardizing the benefits of current or near-term retirees. Two plans proposed by the commission would eliminate the long-term deficit in Social Security. Both plans entail large benefit reductions for future retirees while still requiring substantial infusions of cash into the Social Security system.

This is the bottom line: there is no silver bullet to fix Social Security. Any realistic plan is likely to require a lot of cash to make it politically viable. Yet Mr. Bush allocates trillions of dollars to permanent tax cuts (mainly for the rich) and not a single additional dime to Social Security. Forgoing parts of the president's tax cut that will take effect over the next decade could provide the funds necessary to address the Social Security gap.

We can't afford this budget binge of irresponsible tax policies based on unrealistic accounting. Earnings projections that sounded far too good to be true on Wall Street have turned out to be illusions, even though the public desperately wanted to believe in those numbers. The same is true with bad numbers in the federal budget — the principles of arithmetic can't be denied. If the tax cuts are left in place, high-income individuals, including billionaires exempted from estate taxes, stand to gain while future retirees and taxpayers will lose.

President Bush has called for honest accounting in corporate America. The administration could set an example with an honest budget that ensures that retirees will have the nest egg they depend on most, their Social Security benefits. And to make that a reality, Congress should repeal the tax cuts that have not yet been phased in.

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