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It Looked Good on Paper

By DANIEL ALTMAN

IN a flash of intuition, Michael J. Boskin had found a silver bullet. Or so it seemed.

About six months ago, Professor Boskin, an economist at Stanford who was chairman of the Council of Economic Advisers under the first President George Bush, released a paper suggesting that the federal government had a bounty of $12 trillion coming that no one had bothered to count.

Baby boomers and others, who spent decades making tax-free contributions to their I.R.A.'s and 401(k) plans, would soon begin paying taxes on withdrawals from those accounts, Professor Boskin noted. The windfall from all that, he argued, would more than cover the deficits in Social Security and Medicare. He even suggested that the government sell securities abroad, backed by the expected revenue, to cover its more imminent deficits.

But now it appears that Professor Boskin fired a blank. On July 17, after his ideas were discussed on TV, he quietly notified his colleagues that his equations contained an error. Though he is busily overhauling his paper even now, his latest moment of fame may have already passed.

Professor Boskin worked in the White House throughout the Bush administration and, in the mid-1990's, headed a much-publicized Congressional commission to improve government measures of prices. In those years, he was known as

a smart, hard-headed insider who did not hesitate to tell Congress, federal agencies and even the Federal Reserve how to do their jobs.

But in the last seven years, apart from periodically advising the second President Bush and making occasional television appearances, Professor Boskin said little that was heard outside the academic universe. That was, until January, when he released his bombshell paper.

When word of his findings entered the public domain, Professor Boskin instantly became a darling of the business news media. "The doom-and-gloom red-ink budgetary forecasts of recent years have overlooked some astoundingly good news for the government," crowed Barron's in its issue of June 16. BusinessWeek declared Professor Boskin "clearly back on top of his game" in its June 30 issue, calling him "the Alan Greenspan of his generation."

Yet while the news media were bubbling with praise, the academic backlash was coming to a boil. On Feb. 10, just weeks after he drafted his new paper, Professor Boskin presented his results at a seminar held by the economics department of the University of California at Berkeley. Immediately, said Emmanuel Saez, an associate professor at Berkeley who attended, participants took issue with one of his crucial assumptions: that the I.R.A.'s and 401(k) plans were earning a much higher effective return than the government was paying on its debt.

TYPICALLY, an unpublished paper like Professor Boskin's would have circulated among academic economists, who would then have offered their comments in private. But in this case, Alan J. Auerbach, the organizer of the seminar, joined William G. Gale and Peter R. Orszag of the Brookings Institution, a research group, to rebut the work of Professor Boskin even as he was revising the paper.

They reiterated the question about rates of return and raised

several new, equally profound concerns. To begin with, they wrote, the vision of trillions of uncounted dollars to save Social Security and Medicare was just a mirage. The government's statistics already account for the effects of all the contributions, they wrote, and about 85 percent of withdrawals from tax-deferred saving accounts.

The three also said Professor Boskin was overestimating the tax rates that would apply to the withdrawals, another factor that would artificially inflate the amount of revenue the government might garner. Then they took issue with his assumption that all changes in private saving by Americans would be matched by new corporate investment in the United States.

Indeed, this last assumption by Professor Boskin was a trifle contradictory. Early in his paper, he called the notion that a dollar of debt sold by the government would replace a dollar of corporate investment an "unrealistic assumption in an open economy." But if foreigners could buy Treasury bonds, why could Americans not send their savings overseas, too?

While Professor Auerbach and his co-authors prepared their paper, other commentators took a whack at Professor Boskin's results. Bruce Bartlett, a senior fellow at the National Center for Policy Analysis, a lobbying group, complained that the government would not be able to sell bonds backed by the deferred tax revenue. "It's not like a corporation that suddenly discovered an asset that it didn't know it had," he said in a phone interview last week. "Everybody realized, after they thought about it for a while, that there was less there than met the eye."

Academics, meanwhile, spotted yet another problem. When people take money out of I.R.A.'s and 401(k) plans, securities like stocks and bonds are sold. Because these people are often retired, they may spend most of the withdrawals. The more they spend, the more the nation's stock of private saving falls.

When that happens, according to Professor Boskin's own assumptions, businesses would invest less in new projects, and their ability to generate profits would therefore decline. With

smaller corporate profits, the government would lose revenue from the corporate income tax — enough to offset a substantial chunk of the revenue gained from the individuals' withdrawals. But Professor Boskin, it seemed, did not take this into account.

This month, on the same day Professor Auerbach and his colleagues released their report, Professor Boskin sent a short, apologetic e-mail message to a number of notable economists and pundits. He wrote that most of his paper was correct, but he acknowledged that his equations had indeed omitted the complete effect on corporate investment.

"While the qualitative discussion remains valid, this did lead to a considerable overstatement of future deferred taxes," he wrote. "I am in the process of correcting this problem."

He also called Douglas J. Holtz-Eakin, the director of the Congressional Budget Office, to notify him personally of the flaw. Professor Boskin serves on the budget office's advisory panel and, Mr. Holtz-Eakin said, his ideas had contributed to a similar analysis of deferred tax revenue in the coming decade.

"He made a real effort to let me know that he had made this mistake," Mr. Holtz-Eakin said.

Professor Boskin, reached by telephone last week, defended his main point. "The government has already included the bulk of what's been lost in the contributions, and is yet to collect on the withdrawals," he said. "A balance sheet for the government would show a large deferred tax asset, currently roughly equal to the national debt held outside the government. And that will grow substantially in the future."

"Mistakes were made in the projection of business taxes and interest, and in circulating the draft electronically," he added. "But the Auerbach, Gale and Orszag criticisms also deal with other issues in dispute between us that have nothing to do with this matter."

For the moment, however, economists' hopes for a "pot of gold,"

as Barron's first called it, have been dashed. Meanwhile, Professor Boskin will be girding for the next joust with his critics.

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