



# Social Security Choice

## ***SOCIAL SECURITY THIS WEEK***

A WEEKLY NEWSLETTER ON SOCIAL SECURITY REFORM

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### **National Review: *Republican Silence on Social Security Is a Mistake***

An editorial in the May 31, 2004, edition of the *National Review* calls on Republican leaders to end their silence on Social Security reform this election year. The lack of public debate on the matter, ostensibly due to fears that debate might cause problems for Republicans in November, will hamper President Bush's efforts to promote the "ownership society" theme in the presidential campaign, according to the editorial. On top of that, continues the *National Review*, silence on the issue won't prevent the problems Republicans are trying to avoid. The text of the editorial follows:

"In his 2000 campaign, President Bush promised to reform Social Security by allowing individuals to invest some of their funds. That promise helped Bush reduce the Democratic advantage on the issue. In December 2001, a commission appointed by the president outlined some reform options and explained how private accounts could help solve Social Security's financing problem while also yielding other benefits.

"The elections the next November took place under adverse circumstances for supporters of personal accounts: near the bottom of a bear market, and in the aftermath of corporate-accounting scandals. Democrats pounced. Yet Republicans who supported the idea won hard-fought Senate races in Minnesota, Missouri, New Hampshire, and North Carolina, and House races in Indiana, Kentucky, Minnesota, Pennsylvania, and West Virginia. The few Republicans who ran away from the idea lost. It would seem to be reasonably well established, then, that personal accounts are a winning issue for Republicans.

"Yet the top House Republicans—including Speaker Denny Hastert and Majority Leader Tom DeLay—are still nervous about raising the issue. So far, President Bush has been deferring to their fear by not campaigning on Social Security.

"This silence is a mistake for several reasons. It will not prevent Democratic attacks on all the Republicans for wanting to throw Granny in the snow. It will keep Bush from building a mandate for reform. And it will, therefore, all but guarantee domestic drift and even larger government in Bush's second term. That assumes, of course, that he gets one. But silence in Social Security makes it impossible for Bush to campaign on his most promising domestic theme: that he is creating an 'ownership society' in which people have greater control over their futures.

“The White House has been trying to bring the House leaders on board. If they continue to balk, however, it will be up to Bush to make it clear that the Republican party stands for personal accounts. Bush has already provided leadership on the issue. This is no time to stop.”

### ***Philanthropy Magazine: Private Retirement Accounts Will Help the Working Poor Create Wealth***

An article in the May/June edition of *Philanthropy* magazine, a publication of the Philanthropy Roundtable, points to what it calls “[The New Consensus](#),” the description of which reads, “Left and right agree on the need to teach the poor how to save, manage, and make money.” Author Michael Hartmann discusses the options for asset building among the working poor, including education in entrepreneurship, Individual Development Accounts (IDAs)—which are discussed in detail in the article—and Social Security reform. Hartmann’s discussion of Social Security reform as an element of what some call “asset-based welfare policy” follows:

“IDA matching contributions [from private donors, philanthropic organizations, or various state resources] can only be successful if the working poor can take advantage of them, and many either cannot or do not. ‘There is a limit to how much the lowest-income individuals are able to save,’ writes Michael D. Tanner of the Cato Institute. ‘Given the large proportion of fixed costs in the average household budget, low-income workers simply don’t have much discretionary income. Evidence from employer-sponsored savings plans, such as 401(k)s, shows that even with fairly generous matching grants only a minority of those eligible can be induced to participate.’

“The lack of disposable income that appears to be a problem for IDAs is not a problem for another policy proposal—individualized Social Security accounts. Workers are already required to ‘save’ the monies that go to Social Security; the question becomes whether it’s in the working poor’s best interest to have them continue to send that money to the Social Security Administration or invest it themselves.

“Given that African Americans have shorter life expectancies than whites, Tanner writes, ‘millions of African Americans are being deprived of the opportunity to pass on their wealth to their children,’ making this ‘a civil rights issue as well as an anti-poverty one.’ Blacks ‘are underrepresented among Social Security beneficiaries and overrepresented among Social Security taxpayers,’ observe Harry Alford, head of the National Black Chamber of Commerce, and John C. Goodman, president of the National Center for Policy Analysis.

“Because the present Social Security system cannot be sustained once the baby boomers begin to retire, changes are inevitable. And any change, observes Cato Institute senior fellow Jagadeesh Gokhale, formerly senior economic adviser to the Federal Reserve Bank of Cleveland, will especially affect ‘low-income Americans, who disproportionately depend on Social Security for their retirement income.’

“Unfortunately, the current, unreformed Social Security system prevents asset accumulation by the working poor in three ways. First, it takes income from them that

they could save—in IDAs or other mechanisms—and invest on their own, at better rates of return than Social Security provides. Second, it acts as a disincentive to individuals' saving for retirement on their own. Third, Social Security benefits typically end at death, so that unlike genuine savings they can't be passed on to heirs.

“Under an individualized Social Security proposal put forward by President Bush's Commission to Strengthen Social Security, all workers could contribute 4 percent of their eligible earnings, up to \$1,000 a year, into a private investment account. Other proposals would allow progressively more contributions from the lowest portions of earned income, giving low-income workers even better opportunities to save, invest, and accumulate real assets.

“It's hard to see why the various funders and groups supporting Individual Development Accounts shouldn't welcome Social Security reform. IDA advocate Michael Sherraden confessed to the President's Commission, 'I have spent a good part of the past 15 years thinking, studying, and writing about assets and the poor. From the outset, I suspected that, sooner or later, this work would connect with a discussion of individual accounts in Social Security.'

“The present system's inequities aren't small. One RAND Corporation study several years ago calculated that, given differences in life expectancy and marriage rates, the net lifetime income transfer through Social Security from African Americans to whites is as much as \$10,000 per person. 'A single, low-income African-American male born after 1959 is likely to lose money in the current Social Security system,' writes Heritage Foundation research fellow David C. John. Because Social Security benefits make up such a large proportion of the 'savings' of the poor yet can't be inherited, two prominent economists have estimated that Social Security doubles the share of wealth owned by the richest 1 percent of Americans. And, Tanner notes, another study has found that the concentration of wealth in the country 'would be reduced by as much as half if real wealth were substituted' for the poor's Social Security 'wealth.'

“Reform of the nation's largest social program can only come through the political process, and the challenge may seem overwhelming at the moment. Yet the same was true of America's welfare system until less than a decade ago, and unprecedented reform did occur, with the greatest benefits flowing to the poor who had been trapped in a system that kept them out of the work force and forbade them personal assets. That reform would not have come about without sustained philanthropic support for research, pilot projects, and public education campaigns.”

As noted in the article, President Bush's Commission to Strengthen Social Security advocates private accounts equal to four percent of a worker's income. The Cato Institute plan, [“The 6.2% Solution,”](#) calls for accounts equal to half the payroll tax, or 6.2 percent of a worker's income.

## ***Private Accounts Provide Pre- and Post-retirement Benefits***

In addition to an increased rate of return on pension contributions, private accounts can provide immediate benefits for a country's population—an aspect of Chile's private pension system highlighted by Joshua Goodman in his *Business Week* op-ed, "[Putting Chile's Nest Egg to Work](#)." By financing a wide range of business ventures, Chile's system of private accounts allows workers to reap economic benefits from their pension plans long before they retire. The assets accrued in private pension plans are placed directly into Chile's economy as investments in toll highways, airlines, and retail chains through which future retirees may gain immediate benefit. Those benefits combined with an increased rate of return make private accounts an attractive option for countries needing to address the fiscal solvency of their social security systems.

Goodman begins: "Drivers in Chile don't have to wait until they're 65 to enjoy their pension benefits. Every day thousands do so when they speed from Santiago to Viña del Mar along the Rutas del Pacífico toll road, which opened on Apr. 13 with funding from the country's deep-pocketed pension funds. A billboard reminds passing motorists: 'Your savings are financing this highway, and this highway is financing your retirement.'

"Indeed, this year alone, the government's privately managed Pension Fund Administrators, or AFPs expect to buy nearly \$1 billion in locally issued bonds to fund projects such as the new highway. And the AFPs expect to earn a healthy return on that investment: Annual real returns have averaged 10% for the last two decades. 'It's a perfect circle for everyone involved,' says Alvaro González, local manager for Sacyr, a Spanish construction company that operates the highway.

"The new expressway is the latest requisite of a 23-year-old government-mandated but privately managed pension system that oversees some \$50 billion in assets. That's the largest such pool of funds in Latin America, even though Chile is only the region's sixth-largest economy. The pension system's kitty has grown so fast, in fact, that the government relaxed its pension laws in 1996 to allow money to be invested outside Chile and to fund public works. Among the big-ticket projects funded recently: the extension of Santiago's highly efficient subway system, hundreds of miles of highways, and construction of nearly 500,000 homes for low-income families. 'Without the AFPs, it's unlikely Chile would have the modern infrastructure it does,' says Axel Christensen, an executive with Santiago-based Moneda Asset Management."

Goodman then describes the roots of Chile's reformed pension system. He writes: "Back in 1981, during the rule of dictator Augusto Pinochet, Chile replaced its pay-as-you-go retirement system with the 401(k)-like savings and investment program, which is fully portable—meaning workers' portfolios move with their jobs. The reform was an attempt to defuse a fiscal time bomb brought on by an aging population. Under the pension scheme, each month the 95 percent of Chilean workers opting into the system have 10 percent of their salaries automatically routed to the pension fund of their choice. Although overseen by the Labor Ministry, the money is managed by one of six private AFPs, which were initially set up by local investors as highly regulated mutual funds that invested mostly in domestic equities and government bonds."

As for the concrete benefits of private accounts, Goodman notes that “[t]he Chilean government estimates that 10% of the country’s growth since 1981 is directly or indirectly attributable to the new pension system, thanks to investments bankrolled by AFP funds. In the same period, the money under management at the AFPs has grown to the equivalent of 70 percent of gross domestic product. And since early retirement options were introduced in 1988, the average monthly pension benefit for workers retiring early has increased from \$258 to \$318. The average retired worker in the U.S., by comparison, gets \$925 under Social Security, even though the U.S. has eight times Chile’s per-capita income. No wonder the ‘Chilean model’ of pension reform is being emulated in a wide range of countries, from Poland to South Korea.

“Chile’s pension system has generated a critical mass of capital that has made the country’s financial markets the most sophisticated in Latin America. Hundreds of Chilean companies—from retail chain Falabella to airline LANChile—today depend not on the whims of foreign investors but on the AFPs, which control 70 percent of the local equity and bond market. The only downside appears to be the local markets’ dependence on the AFP funds—and the possibility of an asset bubble at some point.”

Goodman concludes: “But the bottom line for most Chileans is that they’re living better than ever in their golden years. And their economy is all the better for it.”

## ***Upcoming Events***

American Enterprise Institute will be hosting a daylong event entitled “[‘Socially Responsible’ Investing and Pension Funds](#),” on Monday, June 7. “Socially Responsible” Investing (SRI) is the practice of taking non-financial criteria into consideration when making investments, especially those made by governments and employers for workers’ pension funds. The conference panelists will discuss the public policy implications of such practices, including the implications for state-run pensions. For more information, call Ryan Stowers at (202)862-5806.

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