

Outside view: An elegant solution

By Richard W. Rahn

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WASHINGTON, Aug. 24 (UPI) -- Everyone knows we have a Social Security problem; yet few people really understand it. Even fewer understand what the real alternatives are.

Norman Bailey, the former chief economist for the National Security Council who now resides at the Potomac Foundation, and financial economist Criton Zoakos have developed an elegant solution to the puzzle.

To understand the problem, one needs to realize that Social Security is a grand government sponsored "Ponzi" scheme. In order to sell the Society Security idea politically, the Roosevelt administration in the 1930s realized that they could not convince people to pay taxes into a real insurance fund before people starting receiving benefits.

They developed a program where current workers pay taxes to pay the benefits to current retirees. Early recipients received benefits even though they had paid little or no tax.

For the first several decades of the Social Security program, retirees received far greater payments than they had paid in taxes -- hence they loved it.

In recent years, workers have suffered a heavy Social Security tax burden with diminishing returns on this investment, and the situation will continue to get worse and worse.

There in fact is no "Social Security trust fund." All of the money that has been paid in Social Security taxes has been used to fund Social Security payments and other government programs.

The "trust fund" consists of nothing more than an accounting entry at the Treasury Department that in essence says that future taxpayers have an obligation to pay future Social Security benefits.

The original scheme could have only worked if the number of new workers entering the program was growing much faster than the number of retirees.

People are having fewer and fewer children and living to much greater ages. Those who claim there is no problem with the present system either cannot do basic arithmetic, or believe that suddenly the birth rate is going to rapidly increase and life expectancies are going to rapidly decrease.

The other alternatives are to increase Social Security taxes forever, to greatly increase the retirement age, or to slowly transform the system into a fully funded private pension program.

The problem with the never ending tax increase solution is that as Social Security tax rates rise workers have less disposable income and a reduced incentive to work, and employers will have a reduced incentive to hire new workers.

This will result in higher and higher unemployment rates and lower real incomes -- not what most of us would like to see.

The alternative of increasing the age of retirement is already in current law, except the slated retirement age increases are insufficient to deal with the funding problem. If you say to the next generation, the good news is that you are going to live to an average age of 95, but the bad news is that you will have to work to age 80 to get your Social Security benefits -- most people will not think that is a splendid idea.

This leaves the private plan alternative, the only one that can provide a higher real retirement benefit without major tax increases or substantial increases in the retirement age.

The Chilean economist Jose Pinera developed the world's first major and highly successful private social security program a quarter century ago.

Pinera, working with the Cato Institute, is helping many countries create Chilean like systems.

The experiences of Chile and other countries show that well-planned private programs can provide higher real benefits, more flexibility and lower real costs. Critics of this approach complain that volatile stock markets expose retirees to "unacceptable risks." Well, stock markets may be risky, but over the long run they have performed very well.

For each dollar an investor put into the Dow Jones Industrial average stocks in 1958 -- a very good year for the market -- that investor would have about \$16 in 2001 -- a bad year for the stock market -- with which to begin his retirement. This return is many times the rate of inflation or the return on government bonds.

No system is without risk. Without growing economies, all of the present and proposed systems, both government and non-government, will eventually collapse. The proper question is, are their ways of reducing risk and volatility and transition costs in moving to a private funded system?

The Bailey/Zoakos variation has the potential to solve much of the problem. Their insight is that it is possible to "pre-fund" part of the private retirement accounts by selling part of the future stream of required payroll tax or contributions made by workers.

This concept can be best understood by analogy to the existing mortgage-backed securities. Many mortgages are written by banks, which, in turn, sell them to companies like Fannie Mae and Freddie Mac. These companies, in turn, package groups of mortgages into financial instruments known as mortgage-backed securities that are purchased by investors. Under the Bailey/Zoakos plan, investors would buy securities backed by Social Security contributions from a government created organization.

This pre-funding of "Private Requirement Accounts" has a number of advantages, including risk reduction for retirees, more flexibility in retirement options, and a more orderly transition to a private system.

Bailey and Zoakos assert that their plan "provides for a 4 percent annual increase of real -- after inflation - - benefits for all present and future retirees without any tax increase and without delayed retirement.

Moreover, it provides for (1) a \$4.3 trillion surplus for the Social Security Trust Funds by the end of the transition period, (2) for retirement benefits at that time that will be 67 percent higher than they would have been had the present system been solvent, and (3) for the elimination of 10 percent out of the 12.4 percent of the FICA tax burden."

This may sound all too good to be true, but the proposal has been reviewed by highly qualified experts and found to be sound. The complete proposal can be found at PotomacFoundation.org.

Jose Pinera, Norman Bailey, Criton Zoakos and many others have shown that, once the ignorance and the bombast are removed from the debate, it is indeed possible to develop solutions to the Social Security problem that are less painful and more beneficial than what the government has forced upon us.

-- Richard W. Rahn is chairman of Novecon Financial Ltd., and a senior fellow of the Discovery Institute.

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