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A Working Model

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If you were asked to name one person who has enabled more people to gain wealth and security than any other person on the globe, who would you name?

In 1881, here in Berlin, Otto von Bismarck started the world's first modern pay-as-you-go social security system which served as the model for the U.S. Social Security system and that of many other countries, including setting the retirement age at 65. No, Bismarck is not the answer to the opening question, the answer is Jose Pinera, and here is why.

Bismarck's social security system was basically a Ponzi scheme whereby young workers pay taxes to support the retirees. It only works over the long run where the population is growing and where most retirees do not live very long.

These conditions no longer exist in the high-income countries. And even in low- and middle-income countries, population growth has slowed, and lifespans increase rapidly. As a result, many of the world's social security systems have become retirement insecurity systems as they head toward bankruptcy.

Thirty years ago, a young Jose Pinera, who had earned a Ph.D. at Harvard, was Chile's labor minister. He saw the coming disaster in the government old-age pension system.

Inspired by an idea from the late Nobel Prize winning economist, Milton Friedman, he developed a solution that empowers workers and gives them real financial security. Pinera-type social security systems have now been adopted by more than 30 countries and cover several hundred million people — for a very simple reason — it works!

Under the Pinera-type social security systems, workers are required to invest in highly diversified, qualified funds. Because they actually own their pension funds (like 401(k) funds in the United States), workers can choose their age of retirement, whether it is age 50 or 80. The longer they work, the more money they will have — but again each individual determines his or her own retirement

age. (The very poor and those unable to work are still covered by a government system.)

Mr. Pinera is here in Berlin, selling his concept to German opinion leaders, as part of a multi-country "Free Market Road Show" sponsored by the European Center for Economic Growth and the Hayek Institute of Vienna, Austria.

The Chilean privatized system began in 1981, exactly 100 years after Bismarck instituted his system in Germany. It has been 29 years since the system went into effect in Chile so Mr. Pinera now can answer his critics, not only with theoretical arguments, but with hard data.

The results are remarkable. Chile's citizens have on average experienced a 10 percent per year, above inflation, compounded growth rate in their pension funds for the last 29 years. The result is most Chileans are no longer poor, but are, in fact, "small capitalists."

The Chilean government, increasingly freed from paying pensions out of tax funds (almost all Chileans have moved into the private accounts, though they could have stayed in the old government system), is now running a budget surplus of 10 percent of gross domestic product (GDP), which could pave the way for the abolition of the income tax.

The new Chilean system has provided so much investment capital that Chile moved from being a poor country to being a solid middle-income country with the highest per capita income in South America. Critics in the U.S. and elsewhere claim investing pension funds in stocks and bonds is risky, but the real risk to the elderly is being trapped in government social security schemes headed toward insolvency.

In 1981, the Dow Jones stock average stood at about 800. Despite all the ups and downs over the years, and the turmoil of this last year, the Dow Jones average stands about 12,800 or about 16 times where it was in 1981. Those Americans now retiring on Social Security will unfortunately receive only very modest payments in relation to what they could have received if their political leaders had not kept them locked into a fiscally unsustainable government system.

Some critics of privatized social security claim that even though the returns are better under a privatized system, the "transition costs" are too great. In fact, there are no economic costs to the country of the transition, as Chile and other countries which have adopted the privatized system have shown.

We now know that both in theory and practice privatized social security works far better than pay-as-you-go government systems. Opponents can only keep their citizens from adopting Pinera-type systems by keeping them ignorant of the

benefits, and making false statements about the privatized social security system's successes. Fortunately, the world still has a very vigorous Jose Pinera, who for three decades has made it his life's work to empower workers and make them small capitalists, freed from the government foot upon their necks. Mr. Pinera has already made life more secure and prosperous for millions, and with luck it will soon be billions of people.

John McCain and Barack Obama, are you listening?

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