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A Socio-Economic Analysis of the Three Paths to Social Security Reform

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As this century ends, old-age pension systems worldwide are experiencing tremendous strain and undergoing rigorous examination. At issue is the ability of current schemes to survive demographic changes which threaten to bankrupt most OECD (Organization for Economic Cooperation and Development) members' old age pension systems by the early part of the twenty-first century (Peterson, 1996; Steuerle & Bakija, 1994; World Bank, 1994). A variety of proposals have been advanced in response to this concern, which reflect different underlying values and priorities. Varying significantly in their recommendations for the appropriate balance between public and private efforts, these proposals form a continuum of policy choices ranging from the ameliorative model (first advocated by the Organization for Economic Cooperation and Development) to the fully privatized model (recommended by the Cato Institute). Between these two extremes, the World Bank and others recommend diversification of the public-only format by relying more heavily on other retirement-income sources. These three alternatives to pension reform—the ameliorative, mixed and privatized models—have economic and social implications. The emerging field of socio-economic theory merges dimensions of economics and social science to create a broader perspective that accounts for both cost-benefit analysis and humanistic considerations. Applying this approach, six socio-economic criteria have been identified to conduct a systematic comparison and assessment of the ameliorative, mixed and privatized paths to Social Security reform.

As this century ends, old-age pension systems worldwide are experiencing tremendous strain and undergoing rigorous examination. At issue is the ability of current schemes to survive demographic changes which threaten to bankrupt most OECD
members' old age pension systems by the early part of the twenty-first century (Peterson, 1996; Steuerle & Bakija, 1994; World Bank, 1994). By the year 2040, the proportion of the population over age 65 in most OECD countries is expected to reach 22.2%, up from 9.7% in 1960 (Gilbert, 1998). Moreover, the "support ratio" (number of worker's contributing to old-age pension funds relative to the number of beneficiaries receiving payments) has declined dramatically. In the United States, for example, the support ratio has changed from 16:1 in 1950 to 3.3:1 in 1995 (Bosworth, 1997). While it is not necessary to have sixteen workers supporting each retiree, the prediction that the ratio may fall to below 2.0 to 1 by the year 2030 is daunting (Peterson, 1996; SSA, 1995; Shipman, 1995). One of the most important questions raised by the fiscal strains on public pensions concerns the extent to which it is necessary to intervene in the traditional pay-as-you go public schemes and alter the balance between public and private efforts.

A variety of proposals have been advanced in response to this issue, which reflect different underlying values and priorities. Varying significantly in their recommendations for the appropriate balance between public and private efforts, these proposals form a continuum of policy choices ranging from the ameliorative model (first advocated by the Organization for Economic Cooperation and Development) to the fully privatized model (recommended by the Cato Institute). Between these two extremes, the World Bank and others recommend diversification of the public-only format by relying more heavily on other retirement-income sources.

THE AMELIORATIVE APPROACH

The first proposal for reform is largely ameliorative in nature, with a driving philosophy that centers on reinforcing the status quo. From the ameliorative perspective, Social Security is not in significant fiscal jeopardy, and maintenance of the current system through moderate alterations in either indexing or benefit levels is sufficient to sustain the program. One of the first proposals for ameliorative reform was outlined in the Organization for Economic Cooperation and Development's (1988) Reforming Public Pensions. A forerunner in the burgeoning debate
on old-age pensions, the OECD offered three main strategies to relieve the financial problems plaguing the pension schemes in many countries—decrease benefit levels, reduce eligibility, or increase collected revenues. In proposing these general strategies the OECD report sought to avoid confronting issues arising from the unique institutional and political factors that influence specific reform options in any given country.

More recently, several other international agencies including the International Labor Organization (ILO) and the International Social Security Association (ISSA), have supported the OECD approach of recommending incremental rather than radical reform. While neither organization has produced a publication similar to Reforming Public Pensions, the ISSA has been an active participant in re-framing the debate concerning social insurance to encompass broader issues of societal well-being, and the nature of social obligation and social protection. From the ISSA’s perspective, the discourse on Social Security reform has tended to focus on the macro-economic issues of cost, national savings, and competitiveness to the exclusion of social considerations such as solidarity. A current project—the “Stockholm Initiative”—focuses on presenting a balanced range of reform options based on analyses that go beyond a purely economic discussion which concludes that structural change is necessary.

In the U.S. an ameliorative approach to reform was advanced by the majority of the US Advisory Council in the “Maintenance of Benefits” (MB) plan, recommended in the Council’s 1997 report. While the US Advisory Council recommendations resemble those developed by other agencies and organizations, some specific features of Advisory Council and its proposals are noteworthy. First, unlike the OECD, ISSA and ILO, which are voluntary international organization, the US Advisory Council is closely linked with the Administrative Branch of the Federal government—and can be viewed as a limited purpose government body. Second, its analyses are specific to one country and based on reliable data projections generated by the Social Security Administration (SSA). Finally, the Council convenes at regularly scheduled intervals to assess the solvency of the U.S. Social Security system and make recommendations, rather than to develop broader independent contributions to the discussion as innovative ideas arise.
The 1994–1996 Advisory Council spent two-years examining long-term financing, and identifying major areas of concern (U.S. Advisory Council, 1997). The ambitious aim of the Council’s 1997 report was to rectify four problems dealing with (1) the long term balance, (2) the 75-Year Balance, (3) issues related to contribution and benefit ratios and (4) low public confidence. While collectively acknowledging these problem areas, and agreeing on other substantive issues, in 1997 the Council could not arrive at a single, unified set of recommendations. Instead, three separate proposals were included in the final version of the Council’s report, representing the varied perspectives of its members, and of the debate itself. The Council’s report reflects two of the three paths toward Social Security reform—the ameliorative and the mixed approach. While the 1996 Advisory Council’s recommendations were formally announced in 1997, the strategies developed in this report continue to frame the debate in 1999. For example, recent proposals by Senator Moynihan and others draw heavily on ideas advanced by the Advisory Council.

The Advisory Council’s majority Maintenance of Benefits proposal is largely ameliorative in nature and features a series of minimalist reforms which the Council insists will eliminate the shortfall in 2010 and improve the long-term actuarial balance of Social Security. The plan recommends an increase in income taxes on Social Security benefits, and the redirection of funds earmarked for the Hospital Insurance (HI) Trust Fund to OASDI. Other strategies involve inclusion of new State and local employees currently not covered by Social Security, and a 1.6 percent combined employer-employee payroll tax increase in 2045. Lastly, the plan advocates “serious consideration” of Government investment of a portion of trust fund assets in the equities market—however this important recommendation was not elaborated upon in any detail.

Ameliorative designs for reform encompass various types of minor modifications to the existing Social Security system. Most proposals advance an agenda of conservative adjustments, which claim to reduce or eliminate the long-term shortfall, without altering the basic nature of the system. Indeed, the ameliorative approach by definition seeks to maintain the status quo, and offers little in the way of innovation. Thus, analysis of the impact of
ameliorative reform would strongly parallel an assessment of the current pay-as-you-go funded system of Social Security.

THE PUBLIC-PRIVATE MIX APPROACH

A second strategy for reform centers on the transformation of retirement income away from a dominant publically funded old-age pension, toward a system which incorporates both private employment pensions and personal savings.

The World Bank is among the strongest proponents of this type of diversification. There are five separate agencies which are collectively referred to as the "World Bank Group". Two of these five organizations comprise the "World Bank"—the International Bank for Reconstruction and Development (IBRD) (founded in 1946) and the International Development Association (founded in 1960) (World Bank, 1996). The Bank is a quasi-political conglomerate, whose goal is to reduce poverty and improve living standards by promoting sustainable growth and investments in people (World Bank Group, 1995). The World Bank is a significant participant in international social policy debates, and utilizes its funding sources, drawn from subscriptions, income from loans, and government funds, to advance views about a variety of issues.

The World Bank's influential but controversial study, *Averting the Old Age Crisis* (1994) presents the a model for world-wide reform of old-age pension systems which claims that both old-age security and financial growth would be improved if governments develop three "pillars" of old-age security. As illustrated in figure 1, this model includes: 1) a publicly managed system with mandatory participation; 2) a privately managed, mandatory savings system; and 3) a reasonable level of voluntary savings (World Bank, 1994). The World Bank views each pillar as necessary for advancing three separate social aims—redistribution within cohorts, guaranteed insurance, and national savings. The explicit assumption is that one dominant pillar is incapable of meeting the needs of a population, and that it is dangerous to rely solely on a single pillar. However, some scholars take exception to this approach, suggesting that the Three Pillars model both overstates the inefficiency of public schemes and under-represents the high rate of risk inherent in moving toward a partially privatized system (Beattie and McGillivray, 1995).
The World Bank perspective is international, and there are few country-specific recommendations. Instead, the Bank has identified three different paradigms based on existing conditions, a classification which guides later policy discussion. The United States falls within the "Older Economy with Large Public Pillars" typology. This group, composed of other OECD and Eastern European countries, shares certain commonalities that are relevant to the future course of action. The countries possess a rapidly aging population and substantial public pension programs with widespread or universal coverage, upon which the population is dependent. While the degree of urgency varies among nations, most countries confront the imminent insolvency of their public pension systems within the next three decades. Although there are numerous policy options to be decided upon within each pillar, the Bank does not advocate a single model of pension reform. Instead, the World Bank approach anticipates that the design of old-age pension systems will vary depending on the social values which the government seeks to reinforce. The Bank provides a framework for governmental reform by posing a series of questions—the design and outcome of any system is in part dependent on the answers to these questions. These questions concern 1) the advisability of a mandatory public pillar 2) the preferences for redistribution of income 3) the allocation of risk.

**Figure 1
The Three-Pillar Reformed Old-Age Income Security System**

<table>
<thead>
<tr>
<th>Characteristic</th>
<th>Mandatory publicly managed pillar</th>
<th>Mandatory privately managed pillar</th>
<th>Voluntary pillar</th>
</tr>
</thead>
<tbody>
<tr>
<td>Objectives</td>
<td>Redistributive plus coinsurance</td>
<td>Savings plus coinsurance</td>
<td>Savings plus coinsurance</td>
</tr>
<tr>
<td>Form</td>
<td>Flat, or means-tested, or minimum pension guarantee</td>
<td>Personal savings plan or occupational plan</td>
<td>Personal savings plan or occupational plan</td>
</tr>
<tr>
<td>Financing</td>
<td>Tax-financed</td>
<td>Regulated, fully funded</td>
<td>Fully funded</td>
</tr>
</tbody>
</table>

Three Paths to Social Security Reform

4) the merits of a pay-as-you go system and 5) the merits of public management (James, 1996; World Bank, 1994).

A variety of other organizations have produced mixed-approach proposals. The Committee for Economic Development's (CED) plan Fixing Social Security advocates a combination of restructuring the beneficiary criteria—for example, reduction of benefits for a non-working spouse, raising normal retirement age to 70, and slowed benefit growth for upper and middle income workers retiring after the year 2000 (which creates a de facto two-tier system)—and the creation of a new retirement program of Personal Retirement Accounts (PRAs) funded by an additional 1.5 payroll for employers and employees (CED, 1997).

In a similar vein, the two other U.S. Advisory Council recommendations present a mixed approach to reform, which rely more heavily on private investment and private savings. The less radical of the Council's two mixed-approach designs is called the "Individual Accounts" (IA) plan, which creates a dual system—individual accounts alongside the Social Security System. The plan calls for the generation of funds through higher income tax on pension benefits, increased State and local participation, reduction in the growth of benefits, and the acceleration of a scheduled increase in the age of eligibility. Savings produced from these measures, combined with a mandatory employee contribution tax increase of 1.6% would fund individual defined contribution accounts. The individual accounts would be held by the Government, but some investment choices would be available to individuals.

A third scheme advanced by the US Advisory group Council labeled the "Personal Security Account" (PSA) Plan, is the most radical of the Council's proposals, and advocates large, fully-funded individual accounts which would replace a portion of Social Security. The plan involves the redistribution of current payroll tax contributions: 5 percent allocated to a PSA, which would be privately managed and invested in a variety of ways, and the balance dedicated to a modified retirement, disability, and survivors benefit. All vested workers would collect a flat benefit, plus whatever proceeds from their PSA. Like the other two approaches, this plan increases State and local coverage, accelerates the already scheduled age eligibility requirement from 65 to 67,
increases the early retirement age from 62 to 65, and suggests a reduction in the level of future benefits for disabled workers and women who never worked outside the home. However, the proposal also calls for an increase in benefits for some elderly widows.

The Personal Security Accounts (PSA) plan is remarkably complicated, biased toward high-income earners, and risky to the extent that market forecasts may not materialize. Also, since the plan relies upon the financial savvy of individual investors, the very people who most require security in their old age may be least likely to effectively manage the investments that would result in a comfortable retirement. While the PSA's guaranteed flat benefit, (which amounts to $410 in 1996 dollars) provides some degree of security, this is much less than the average Social Security benefit in 1999.

Compared to the Personal Security Accounts, the Individual Accounts (IA) plan navigates a more balanced course between maintaining the level of security currently provided by Social Security, while simultaneously increasing revenues and benefits. Although the IA requires the sharpest and most significant increase in employee payroll contribution at 1.6%, the plan proposes using the tax system to partially neutralize some of the increase by providing advantageous tax deferment classification.

THE PRIVATIZED APPROACH

Finally, privatization of old-age insurance has been advanced as a mechanism for curing the problems confronting the Social Security system. The Cato Institute is among the most active proponents for privatizing Social Security. Cato is a Washington-based think-tank of self-described “market liberals” who value “traditional American principles of limited government, individual liberty, and peace” (Cato's Home Page). Their “Social Security Privatization” project, which began in 1995, is premised on the belief that Social Security in its current form is unsustainable, and that the crisis demands immediate attention (Weinberger, 1996).

Cato advocates a fully privatized social security model, similar to that introduced in Chile in 1981. Through a series of working papers penned by different authors, the Cato project characterizes
the current system as a Ponzi scheme (Borden, 1995), recommends broad parameters which should guide the debate (Feldstein, 1997; Weinberger, 1996), exposes public doubt concerning the viability of Social Security (Tanner, 1996a), and issues warnings concerning the danger of allowing government investment of funds (Ostaszewski, 1997). However, the Project has been less forthcoming about the specifics of a privatized model, other than its admiration of the Chilean system (Shipman, 1995).

The most detailed description of the Cato vision is found in Tanner’s (1996b) “Privatizing Social Security: A Big Boost for the Poor”, which advocates adoption of a mandatory savings program, that would redirect the 10.52 percent payroll tax from OASI to a “Personal Security Accounts” (PSA). Similar to the Chilean defined-contributions model, the PSAs would be fully portable, and managed by the private investment industry. The government would establish regulations regarding portfolio risk to prevent excessive speculation, and provide a guaranteed minimum benefit if necessary (italics added). The retiree would possess a property right to his or her benefit, rendering remaining funds bequeathable upon death (Tanner, 1996a). However, the issue of government regulation is significant, and merits more attention than the Cato project allows. On financial side, the Chilean government continues to play a prominent role in the pension system. A number of the AFPs have failed, been liquidated, or consolidated, and government fiduciary obligations have escalated well beyond estimations. From an administrative perspective, the autonomous government agency, the SAFP (Superintendent of Pension Fund Management Companies), has had limited success at maintaining regulatory standards. Overall, the Chilean government has been more successful in simply bailing out the system rather than monitoring it (Borzutzky, 1997).

Another window to its plan is a description found in a Cato public opinion survey concerning privatization (Tanner, 1996b). According to Tanner, the program would still require joint contribution from employer and employee. However, instead of FICA payments going to the SSA, the individual would be allowed to invest the money in a personal retirement account like an IRA or 401(k), and would decide how to invest the money in this account, with any money left in the account being inheritable. The
participation in the privatized program would not be mandatory, and those who chose privatization would receive some benefits under the old system in recognition of what they have already paid into the current system.

This summary is consistent with other Cato position papers, and clarifies the issue of an employer’s obligation in payroll contribution, which had previously not been addressed. However, the specific mechanism for the transition from one system to another, and the compensation for those who stay in the existing system remain ill-defined. In the end, Cato’s contribution may be less the articulation of a plan, and more the recommendation of a possible direction for the future of Social Security reform, similar to the Chilean model.

In 1981 Chile abandoned its national pension system and adopted a privatized savings plan which makes individuals responsible for their own retirement. The catalyst for reform involved both ideology and fiscal necessity (Passell, 1997). The primary architect of the Chilean model (and Co-chair of the Cato Project) is José Piñera, who was educated at the University of Chicago, under the tutelage of Milton Friedman. Piñera advocated exchanging Chile’s pay-as-you-go national system for that of privately funded individual accounts in response to both the market ideology of the Chicago School and frustration with high payroll taxes—in excess of twenty-five percent, and a patchwork of underperforming industry-based pension plans.

The Chilean privatization scheme is compulsory for all new workers, and optional for existing retirees. The employee contribution rate is set at 10 percent of wages, plus an additional 3 percent to cover costs of disability and survivor’s benefits, for a total rate of 13 percent. The tax is paid exclusively by the employee—there is no employer contribution. Pension funds must be invested with one of the twenty-plus publicly regulated (but privately managed) mutual fund groups known as Administradora de Fondos Pensiones, or AFPs. The AFPs are directed by the government to take limited investment risks, and must maintain a fixed percent of their assets in Government-insured debt, interest-bearing bank deposits, and Chilean equities (Kritzer, 1997; Passell, 1997; Petersen, 1996; Piñera, 1996).
accounts are fully portable, and retirees can access their funds upon retirement at age 65 for men and 60 for women. However, workers may start collecting money from their accounts at an earlier age, provided sufficient savings exist. Retirees may continue working while collecting funds, and there no earnings reduction in their benefit. The Chilean government provides a means-tested minimum benefit paid out of general revenues, but is only available when a low-income worker has "spent down" the worker's personal pension fund. Also, as Borzutzky (1997) notes the privatized system tends to perpetuate both social and economic inequities.

Initially, the experience in Chile appears relatively favorable. In the short-term, high interest rates and phenomenal gains on Chilean stocks have resulted in an average real return on investments in excess of 14 percent. Replacement rates are equally impressive, 78 percent of pre-retirement earnings, and over 84 percent if lump sum withdrawals are included in the calculation (Petersen, 1996). However, a six percent real rate of return is needed over the long term to maintain a target replacement rate of 70 percent (Kritzer, 1996). The long-term performance, of course, remains uncertain—the pension funds have not performed as well recently, dropping to zero growth in 1995 (Passell, 1997), increasing slightly to 3.5% in 1996 and 4.7% in 1997, then decreasing to -2.5% in 1998 (Chilean Superintendent of Pension Fund Management Companies, 1998).

Additionally, the Chilean privatization participation rates are surprisingly low. Although there are over 5 million individuals enrolled in the new system, only about 58% of all enrollees (or affiliates) actively contribute to their individual accounts (Kritzer, 1996). While there are various reasons for non-compliance, low participation among women (26 percent) and the self-employed (37 percent) accounts for a substantial amount of the delinquency (Marcel & Arenas, 1992). Moreover, administration fees, quite high at 4 percent, erode the real rate of return as do additional fees incurred by persons seeking financial advise on which options to choose (Kritzer, 1996; Vittas, 1995). Finally, the claims that a privatized system would increase national savings have failed to materialize (Mesa-Lago, 1994).
Other than the Cato position, few openly advocate exchanging the mandatory public system of Social Security for a privatized model. Baker (1996) observes the insurance and investment industries stand to be big winners in the event of this sort of transformation and may secretly support such a change. Although the World Bank claims to advance a public-private mix, there is some evidence that the Bank is a supporter of a privatized model (James, 1992; Vittas & James, 1994; Vittas, 1993; Vittas, 1995). While the articles do not openly endorse a private approach, the amount of attention devoted to private pensions raises some speculation as to how much of a public role is seen as ultimately desirable in the Three Pillars perspective.

THREE MODELS OF REFORM: A SOCIO-ECONOMIC ANALYSIS

These three alternatives to pension reform—the ameliorative, mixed and privatized models—have economic and social implications. From an economic perspective, classical theory suggests that human behavior is motivated by the desire to maximize utility and minimize the effects of opportunity cost. According to this view, the well-being of everyone is best served when each individual acts in a self-interested fashion (O'Boyle, 1994). Evaluations of social welfare policies from an economic perspective seek to provide a clear measure of cost and benefit, which lead to reforms that reflect an emphasis on cost-effectiveness. In contrast, sociology seeks to explain human behavior in terms of social norms, values, and processes of socialization (Lutz, 1990). The sociological approach to policy analysis tends to emphasize the importance social norms and values prescribed by the community, (i.e. work, self-reliance, social solidarity) more than their fiscal implications. Evaluations of social welfare policy from this perspective focus on how potential reforms might impact factors such as self-reliance and equality.

The emerging field of socio-economic theory merges dimensions of economics and other social sciences to create a broader perspective that accounts for both cost-benefit analysis and humanistic considerations. The Socio-economic perspective relies on a deontological model which tempers the utilitarian-based
paradigm of classical liberalism with moral elements critical to the formation of personality and society (Etzioni, 1988). By introducing the values of "moral consideration" (humility, cooperation) and "social bonds" (membership, structure) into the classical economic model, the socio-economic approach supports policy reforms which take account of both the traditional measures of cost and the value of community. This framework draws the analysts' attention to a broad range of policy issues and values.

Applying this approach, six socio-economic criteria have been identified to conduct a systematic comparison and assessment of the ameliorative, mixed and privatized paths to Social Security reform. The following does not exhaust the range of evaluative criteria but includes those that are among the most important.

1. Equality—Equality (or "vertical equity") refers to the degree of redistribution from the wealthier members of one cohort to the less wealthy of the same cohort.

2. Adequacy—The criteria of adequacy is concerned with the overall economic adequacy or size of the benefit distributed to retirees.

3. Solidarity—Examines the extent to which the proposed reform reinforces the notion of social security as a system of collective responsibility.

4. Individual Equity—Individual equity concerns the relationship between an individual's contribution during his working lifetime compared to the pension benefit received, with special attention to whether an individual's return is "actuarially fair" (Steurele & Bakija, 1994).

5. Administrative Efficiency—Administrative efficiency addresses the cost-effectiveness of a pension systems' administrative structure.

6. Personal Responsibility—The criterion of personal responsibility concerns the influence of governmental policy on individual behavior related to the timing of retirement and personal savings.

The extent to which the ameliorative, the public-private mix, and the privatization proposals rank high, moderate or low relative to each other on these criteria is summarized in Figure 2, discussed below.
Equality

The ameliorative approach to reform supports the conventional model of Social Security, which is premised upon the distributional principle of progressivity of benefits within a given cohort. Although, the universal nature of old-age pension benefits precludes directly targeting benefits only to those most in need, the system of progressive replacement rates acts as a proxy for targeting by ensuring a higher rate of return to lower-income earners. In addition, an indirect method of targeting may be employed through ameliorative reforms that recommend increasing taxation on pension benefits for those in the upper income brackets. In the U.S., for example, the replacement rate benefit formula provides a higher rate of return on contributions of low-wage earners than for those with higher wages. Although benefits are thus generally considered progressive, contributions collected via payroll taxes are regressive in nature since lower income earners are taxed at the same rate as higher income earners.

In the mixed approach to reform, that proportion of benefits derived from the public side of the scheme continue to be based on a progressive benefits formula.

By contrast, reforms favoring a privatized model are least likely to result in redistribution toward the poor. Most plans rely on the admittedly regressive nature of the payroll tax for the collection of revenues, without providing a progressive payment
scheme. However, maintenance of a means-tested minimum benefit drawn from general revenues could ensure a modicum of redistribution, if not vertical equity.

*Adequacy*

On the issue of adequacy, ameliorative reforms tend to favor small reductions in benefits which lower their replacement rate—a trend that is already underway (Steuerle & Bakija, 1994). Average replacement rates vary among OECD member countries ranging from a high of 80 percent in Italy to a low of 40 percent in Canada (Bovenberg & van der Linden, 1997). While policymakers have attempted to ensure the stability of replacement rates by indexing benefits with cost-of-living-adjustments, in the U.S. replacement rates for higher than average wage earners are already lower than a decade ago. [However replacement rates for low and average wage earners are higher than the historical norm (Steuerle & Bakija, 1994).]

Proposals for the mixed model are likely to produce a moderate to high degree of replacement depending on their extent of reliance on the market. Mixed proposals vary greatly in how to structure the movement away from a publicly funded pension system. In the United States, the Advisory Council recommended two separate models—one which creates a dual system of accounts with IAs (Individual Accounts) alongside the existing Social Security system, the other which advocates fully funded individual accounts PSAs (Personal Security Accounts) which would replace a portion of Social Security. Although replacement rates in these schemes would vary with the equities market, the major portion would still be tied to the Social Security benefit.

Proponents of the privatization model suggest that greater reliance on the private market will increase the adequacy of the benefit, creating a positive situation for low and high income earners alike (Tanner, 1996b). However, the ability of a privatized system to generate adequate pension benefits is entirely dependent upon market performance, which in recent years has been strong in the U.S. but not in many other OECD countries, and is uncertain over longer periods of time. Thus, privatization of public pension systems is a risky proposition, unable to ensure the level of future returns.
Solidarity

T. H. Marshall (1964) suggests that the social rights of citizenship form a societal glue that binds together people from diverse backgrounds, and unites them in a common national community. More recently, Etzioni (1988) has discussed the importance of linking values of "social bonds" (membership, structure, etc.) to policy reforms which support both the traditional measures of cost and the importance of community. Some analysts suggest that public pay-as-you-go pension programs may serve this function—by promoting a sense of solidarity among and between generations (Euzéby, 1997). While this argument may resonate more strongly in European countries than in the United States, surveys consistently reveal that Americans express strong support for the Social Security program, even as confidence levels have decreased and uncertainty concerning the availability of future benefits has increased (Reno & Friedland, 1997). Support may be in part attributable to the realization that the Social Security system reduces the obligation and necessity for members of the working generation to directly contribute to the support of their elderly parents. Whether the sentiment of reduced freedom from obligation toward one's parents amounts to social solidarity in the socio-economic sense is questionable. However, from this perspective, ameliorate reform will reinforce the bonds of solidarity, by continuing the traditions of contribution and an intergenerational contract.

It seems unlikely that a mixed system will result in increased social solidarity, unless 1) a mixed system produces substantial gains for everyone and 2) the assumptions which underlie classical economics hold true—that the well-being of everyone is best served when each individual is motivated by self-interest. Instead, class cleavages may further erode solidarity since the middle and upper class may benefit most from mixed reform proposals. Moreover, to the degree that mixed plans call for an increased role for private employment pensions, greater reliance on this funding stream may prove divisive absent policies to provide all echelons of workers with similar accounts.

The move toward privatization is unlikely to engender solidarity among citizens, unless the experiment were so successful...
as to create a sense of comradery for the collective good fortune of the participants. However, to the extent that such a sentiment arises, it would more likely be based on individual self-interest rather than the type of collective social solidarity discussed by Etzioni and others.

**Individual Equity**

Nearly all industrialized nations finance their public pension system based on a pay-as-you-go model in which the current population of workers pay for the retirement costs of current retirees. This arrangement is predicated on an intergenerational contract that promises similar treatment for each successive cohort of retirees, based upon their past contribution (Bosworth, 1997). However, demographic trends (declining support ratios, climbing life expectancies and an increase in the average length of retirement) and economic changes (a real increase in size of benefits for current retirees, lower interest rates) have affected the rate of return compared to the present value of past contributions. Described as a Ponzi-scheme, pay-as-you-go systems tend to generate higher rates of return for early participants with a gradual depreciation for younger cohorts. In their study of the United States's Social Security system, Chen and Goss (1997) found that individuals who retired from 1960 to 1968 received a 12.5 percent real rate or return on their contribution, whereas workers retiring between 1982 and 1987 received a much lower 5.9 percent return, with future retirees experiencing an even lower real rate of return. Thus, ameliorative reform will perpetuate the increasingly larger disparity between the returns experienced by current and past generations of retirees versus current workers and future retirees. As demonstrated by Steurele and Bakija (1994) and others, absent some sort of structural intervention, the passage of time alone is eroding individual equity since some members of future retiree cohorts will experience negative net-transfers.

The transition from a dominant public-pillar model to one which relies more heavily on mixed or alternative retirement sources may present some problems of individual equity. However, a relatively gradual transformation will lessen the burden that any generation must shoulder, and ultimately the move away from exclusive reliance on a pay-as-you-go system will promote
greater individual equity. What differentiates the mixed approach from the fully privatized approach is that by diversifying retirement income sources, no one source is as important. Given the unpredictability of the future economy, a diversified portfolio of retirement income seems the most prudent course for a fair rate of return.

A fully privatized scheme is likely to produce winners and losers even in a regulated system. Thus, privatization will be more inconsistent in providing an equitable return. While in theory all participants could recoup their contributions and even make a considerable gain on investments, an alternative scenario could include an entire cohort of retirees who lose a significant proportion of their retirement savings in the event of having to retire during an economic down-turn. At the same time, privatization offers another definition of individual equity. That is, when employees are responsible for their own retirement whatever the market yields can be considered a “fair” return on their investment.

Administrative Efficiency

The case for ameliorative reform on the criterion of administrative efficiency is positive. Most OECD member nations have administrative infrastructure that efficiently conduct the major management functions of large scale public programs at a low cost. In the U.S. for example, less than one cent of every Social Security tax dollar collected goes to administration, which makes U.S. operation among the most cost-effective programs in the world (Ross, 1997).

The public-private mixed approach would probably be less efficient than the status quo. The infrastructure necessary to manage accounts is not in place, and the costs may be closer to those of a fully privatized model than the very low administrative costs of the current system of Social Security. The administrative costs of privatization will most likely be higher than the current 1% operating cost of the public system in the U.S., and the ability of individuals to opt-out of the current compulsory scheme will raise costs due to economies of scale alone.
Three Paths to Social Security Reform

Personal Responsibility

The ameliorative approach to Social Security reform would do little to modify the behavioral tendencies encouraged by the current system. This is not a positive development in light of the trend toward decreased personal savings, and increased propensity toward early retirement (Peterson, 1996; Steurele & Bakija, 1994). The effect of a public pension on private savings behavior is difficult to quantify empirically (Thompson, 1997). Originally, Feldstein (1974) posited that Social Security would diminish national savings, since government retirement income might reduce the amount private individuals would otherwise save. According to Gramlich (1997), national savings (NS) is a function of the sum of all private, state and local savings (PS), Social Security savings (SS), and all other federal savings (FS), all divided by the total gross domestic product (GDP). While the national savings rate has declined precipitously since the 1960s, and private savings has decreased, this is more a function of the change in deficit spending than disincentives toward savings created by a government retirement benefit (i.e. governmental deficit spending plays a proportionally larger role in the erosion of national savings rates than has the decrease in personal savings) (Bosworth, 1997). Although Peterson (1996) seems confident in his assertion that public pension policy has led to a decrease in personal savings, most others are not willing to draw a causal connection despite the fact that rates of savings have declined.

A clearer case of the effect of pension policy is presented in the area of retirement timing. Quadango and Quinn (1997) suggest that the Social Security system generates strong incentives to retire, and people have responded accordingly. Labor force participation rates among males over the age of 65 have dropped from 45.8 percent in 1950 to 15.8 percent in 1991. (The rates for women have not changed as dramatically—in 1950, 9.7 percent of women age 65 or older were employed in the civilian labor force, versus 8.6 percent in 1991). At the same time, the number of men surviving to age 65 has risen from 53.9 percent in 1940 to 72.3 percent in 1990 (60.6 percent for women to 83.6 percent) (Steuerle & Bakija, 1994). (Total life expectancy as well as total number of
persons surviving to age 64 are predicted to continue to rise well into the next century for both men and women). While the incentive to move older workers out of the labor force made sense at one time, this practice is problematic given the current demographic realities. Not only are people retiring earlier, but they are living longer (and collecting more) than previous generations of retirees. Under ameliorative reform in the U.S. the normal retirement age (NRA) will climb to 67 by the year 2022 (recent proposals recommend raising it further to age 70). This incremental increase in NRA is unlikely to significantly prolong labor force participation in light of strong financial disincentives to work beyond the NRA. Legislated changes slated to take place early next century will minimize some of the current disincentives toward work. However the ameliorative approach does nothing more to promote work among the elderly.

On the issue of behavioral incentives, the mixed model may inhibit the incentives toward early departure from the labor market. This is particularly true if the public portion of the retirement benefit is increased in the event of continued labor market participation, or if the portion of benefits from private accounts engenders a belief that working longer results in personal rewards. Regarding personal savings, the extent to which the mixed system would increase savings behavior is unclear. Although the portion of contribution devoted to private accounts is a form of individual savings, a question remains as to whether people would decrease other forms of private savings as their personal accounts accumulated, with a net result of little or no gain in private savings.

Finally, proponents of privatized pensions suggest this approach would have a strong positive effect on individual savings through the private retirement accounts. As with the mixed model, however, the question remains as to whether the advent of private accounts would diminish other private retirement savings. As for the timing of retirement, there are three ways in which privatization might impact the period of employment: a) pension regulations could mandate that people work for a longer period to be fully vested, or require a particular level of savings prior to retirement b) as with the private portion of the mixed model, the relation between increased work effort and the accumulation of a
private asset that could be passed on to the next generation might
exert an influence for a longer work-life c) also the state of the
market in which the retirement account is invested, particularly
in a period of decline, might provide a stimulus to work longer.

CONCLUSION

None of three of the reform options analyzed in this paper
rank positively on all of the socio-economic criteria. By conduct-
ing a socio-economic policy analysis of the three approaches,
this paper draws attention to values embedded in each path
to system reform. Returning to Figure 2, we can see that the
ameliorative model is strongest on the social criteria, but weakest
on a cumulative ranking on the economic criteria. The privatized
model is the reverse—weakest in the area of social criteria and
strongest on the economic side. The mixed model pooling the
advantages and disadvantages of the ameliorative and privatized
approaches, comes out pretty much as expected with a moderate
ranking across the board. Representing the course of moderation,
the mixed model would seem to offer the safest alternative, if
one’s objectives are to create a retirement scheme that would not
rank too low on any of the areas of concern.

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