

Social Security Privatization: Has Its Time Arrived?

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Introduction

The debate over Social Security's future has been a topic of discussion over the years. Americans want to know what's in store for social security in the future, such as will it still be around for people of my generation. Currently, social security is not looking so good for future retirees. One of the many solutions to the social security problem is privatization. Privatization will allow workers to have money put away in a private account that will accumulate interest from investing in securities. Though plenty of people are against privatization, there are benefits to privatizing social security.

"The most important arguments for Social Security privatization are moral, not economic...A privatized Social Security System gives individuals more freedom to run their lives, is fairer, provides more security, and creates less antagonism between generations, fostering a greater sense of community" (Shapiro, 1998). It makes sense for a worker to want privatization because they have a little more control of how much they invest in their private account. The investment into a private account gives a higher chance of increasing their investment. People take great pride in knowing they have control over their finances. People tend to be more careful over their finances because they know that they are accountable for their future. For example, a person who cares about the future of their well-being will invest more time and money into their private accounts because they want their future outcome to be good. They want to have secure financial stability in their retirement years.

Retirement is one of the most important decisions a person has to make in their life. "Retirement decisions depend upon one's occupation, one's trade-off between work and leisure, one's time preference, the extent to which concern for the future guides one's present plans and goals, and so forth...and all of these are intimately involved with one's self-definition, one's ambitions, and one's goals." (Shapiro, 1998). It means that a person's end result of retirement savings depends on the sacrifices they make in their life as well as opportunities offered to them. These decisions greatly affect whether or not a person will have a financially secure retirement.

Pay-As-You-Go vs. Privatization

To understand the effects of the current Pay-as-you-go system, you would have to compare the intergenerational and intragenerational effects. Intergenerational is relationships between generations and intragenerational is relationships among members of the same generation. Intergenerational effects reflect how workers from the older generations had better benefits than today's workers. When social security started, payroll taxes were low and the rate of return on taxes was higher than the market. This provided better benefits than what is being offered today. What made the benefits better back then was the higher worker to retiree ratio

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because of population growth. Also, the life expectancy was shorter for retirees. Today there is medicine to help people expand their lifespan along with diet and exercise. These days the pay-as-you-go system is going downhill because the opposite is happening. Payroll taxes are higher and the lack of population growth to help stimulate the economy. With the reduced population growth, the worker to retiree ratio has gone down. It started out as 16:1, but eventually it will reach 2:1. If social security were to go towards privatization, then workers are responsible for themselves. They don't have to worry about if they'll get full benefits like they should. Basically, it would be every man for him.

The intragenerational effect is the difference amongst classes. The workers with lower income get more of their taxes taken out than workers with higher income. Also, higher income workers tend to enter the workforce later, so they contribute less to the system. Not only that, the higher income workers live longer during retirement and receive all the benefits since the lower income workers tend to die before age 65. (Shapiro, 1998). It is better for the lower class workers to get private accounts because there isn't a division amongst the classes. It is true that the higher class can contribute more to their accounts, but in the end it doesn't really matter because the market gives a higher return than the pay-as-you-go system. Workers would just be better off taking the risk of the market. It just isn't fair for the low income workers to have all their hard earned money taken away so that the high income workers can live luxuriously in their retirement years.

The children of today are going to be the ones to pay for the social security problem. If something is not done about social security soon, nearly one-fifth of workers income (today's children will be the workers) will go to paying for the retirement of baby boomers. On top of paying the taxes for workers income, they will have to pay hundreds of billions of dollars for income taxes just to help social security.

If social security were to privatize, then the young generation could be part of a defined contribution system, "...thus tightening the link between contributions and benefits and thereby improving work incentives". (Shapiro, 1998) Social security is expected to be fine until 2030, but that is only a prediction. Nobody knows what will happen in the future. Social security may dissolve before 2030 or it may not. Surpluses are expected to happen until 2018 and then social security will have to rely on government bonds. Since surpluses are to be invested in treasury bonds, a security of the U.S. government, any money contributed is available for spending. The bonds purchased are "...mixed with general revenue and then spent on the government's annual general operating expenses". (Tanner, 2005) The interest from the bonds is paid out in bonds. When the government has to pay back the bonds, they use the money from general revenue to pay it back. It is believed that social security is a safe system when in reality it is not.

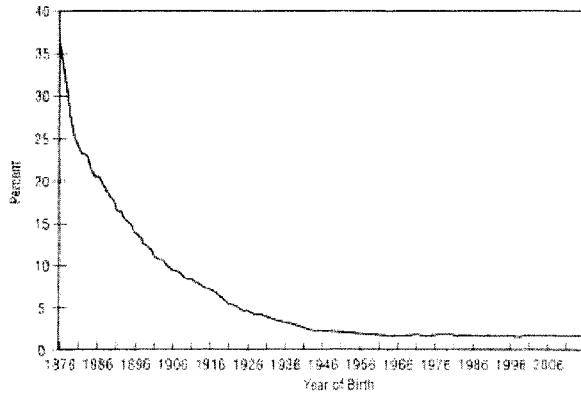
Social security should be used for exactly what it's meant to be used for. The government should not spend it for anything they like. Retired people expect to get back the money they put into the system in the form of benefits. They don't want to be told that the funds in the social security system are almost gone because of excessive spending. It's better to privatize because "...the need to reduce benefits or increase contributions will drive the net return to social security even lower, possibly even negative. Simply put, the existing public

PAYGO pension system is a bad deal for both current and future workers". (Altig and Gokhale, 1997).

The following is a graph of how real interest rates are taking a rapid decline.

Real Internal Rates of Return For OASDI

Source: (Altig and Gokhale, 1997)

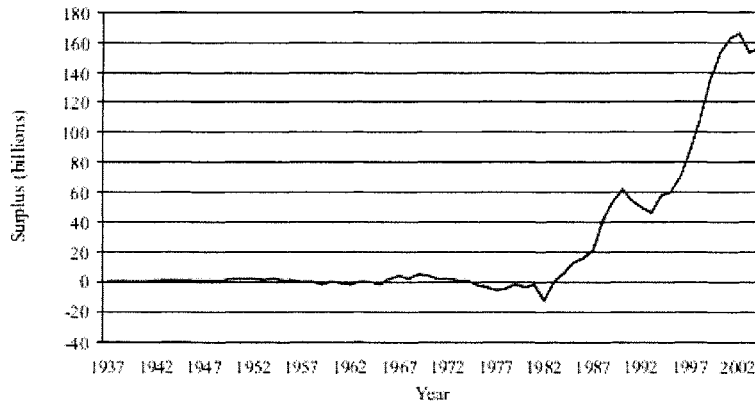


The following is a graph of the social security surpluses from 1937 – 2004 (Tanner, 2005).

Social Security Surpluses, 1937-2004

Source: (Tanner, 2005)

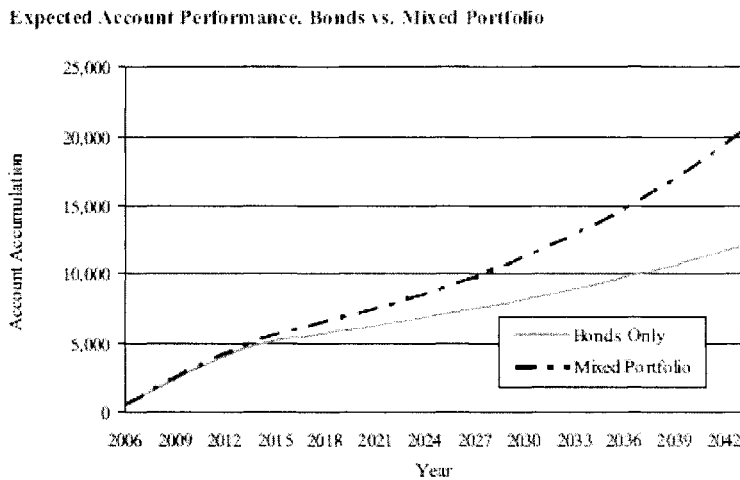
Social Security Surpluses, 1937-2004



The pay-as-you-go system does not guarantee workers their benefits. Since the benefits are not guaranteed, then they can be taken away at any time. There isn't a safety net to keep you safe. People like to feel that they're safe and taken care of. If workers feel that they're not receiving the security they deserve, they'll go elsewhere. Since the pay-as-you-go system is the only social security system in the U.S., people don't really have a choice. When another idea for a social security system comes along, such as privatization, people will most likely view it as an escape. Privatization looks especially appealing when the current social security system is not working so well. The benefits are not inheritable. It means that if a retiree were to die, then he/she cannot pass their benefits to a spouse or child. People feel that they worked hard and should be able to do whatever they please with their benefits. As stated earlier, the current system provides returns less than what the market offers. It doesn't make any sense to contribute money to a system that doesn't guarantee anything. The market doesn't guarantee anything either, but at least there's a chance of getting a good return.

The following is a graph comparing expected account performance for bonds and mixed portfolios. (Tanner, 2005)

Expected Account Performance, Bonds vs. Mixed Portfolio
Source: (Tanner, 2005)



As you can see, if one were to invest in a mixed portfolio, then there would be a greater return.

The U.S. should look to other countries, such as Chile, that have privatized. Chile replaced their old pay-as-you-go system with privatization in 1981. The private accounts have yielded a 10.9 percent rate of return. In order to keep the current social security system in place, "...the United States will have to raise taxes, cut benefits, increase the retirement age or dip into other federal money to meet future obligations".(Strope, 2001)

Conclusion

Privatization may increase the chance of poor people having a better standard of living. If the retiree should die early, the money not spent can be passed on to their beneficiary (next of kin). Workers under a certain age will contribute part of their social security tax to a privately owned account, while “the remainder of the payroll tax would continue to be paid into the current system to finance benefits to current beneficiaries and those above the cutoff age”. (Altig and Gokhale, 1997)

The plan to privatize includes current and future workers. Those who are above the cutoff age will remain in the old system. It’s a process that will take time. It should gradually shift to privatization. There should be a deadline to have all of social security privatized. For example, privatization could be fully functional after the last of the baby boomers has retired. Privatization is just another way for American workers to save for retirement. It’s not the worst idea in the world. It’s just going to take a lot of time and money to change our current social security system to privatization. It’s a matter of who will get together to implement privatization. Is privatization what America wants? Perhaps social security should be split between the current pay-as-you-go system and privatization. If one system goes wrong, then perhaps the other will do well.

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