



THE TAXPAYERS NETWORK

W67 N222 Evergreen Blvd #202
Cedarburg, Wisconsin 53012-2645
262-752-0137
Fax: (262) 752-0132

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Personal Responsibility

The Missing Key to Retirement Security

by Nona Bear Wegner, The Taxpayers Network

How in the World Did We Get Here?

For almost seven decades, Social Security has been portrayed by many as one of the crowning achievements of American government, but that opinion has not been without dissention. As long ago as the 1960s, a small but influential number of economists and lawmakers began to raise serious questions about the program's long term financial viability as well as its impact upon Americans' expectations toward retirement security.

During the Reagan administration, solvency issues reached a critical point. Congress did take action to "fix" the immediate problem, but stopped short of addressing the larger fundamental flaws which were inevitably raised by the crisis. In the late 1980s, the Bush administration, together with a number of scholars reopened discussion about the dismal long term outlook for the program and talk of privatization once more surfaced. Lively debate and provocative research appeared; the media and American people became engaged in the conversation; Congressional hearings on a host of related topics were held, and public opinion revealed that more young adults believed in UFOs than believed that the Social Security system would survive to pay them benefits...but lawmakers have still not acted.

A brief retelling of this history however, does not explain why Congress has failed to act, or more importantly, what it will take to make them do so. That explanation depends upon an understanding of the revered place that Social Security holds in our society and how it came to be called the "third rail" of American politics¹.

Great Expectations

From our 21st century vantage point we view retirement as the last – even golden -- stage of adult life, a "*right of passage*" that everyone is entitled to have and enjoy. But this view of late adulthood is a uniquely modern one, born out of the economic prosperity and medical advances of 20th century that lengthened our life span and our vitality. Just consider for a moment the differences between the lives of a 65 year old at the turn of the 20th century and his counterpart living today.

Retirement for the former was likely to be short in duration because life expectancy was only 61 years versus almost 77 today. The quality of life for a senior in the early 1900s was also a

¹ The third rail of an electric train is the one which carries the current and would electrocute anyone who touched it.

mere shadow of that enjoyed by older Americans today. Most would have received little medical care over their lifetime and lived a much more arduous existence. Pain and the impact of disease would, therefore, exert far more severe limitations on their lives. Finally, retirement life in the first decades of the 20th century (and for the few who had made it throughout history before that time) was very simple in execution; there were no retirement golf communities or Elderhostles. Retirement meant the end of work, not a lifestyle choice. Consequently the financial needs for such a life were also quite different. Put simply, retirement security used to require less because retirement was itself less.

In the first decades of the 20th century, however, this pattern changed. *For the first time in the history of the world more people began to grow old before they died, than died before they grew old.* A fundamental paradigm had shifted. It is understandable and entirely reasonable therefore, that at the beginning of this phenomenon neither the individuals themselves, nor their families, nor society were prepared. Personal savings and family support, the primary ways in which the aged had been cared for throughout history were not enough. Charity, the lone safety net, could not carry the extra burden. Social Security was the response.

The Three Legged Stool

Until the creation of the Social Security program, there had been only two mechanisms upon which retirement security rested – personal savings and (for some) private pensions. The framers of the Social Security System intended it to be a third or balancing leg that added stability to the lives of the beneficiaries. It was designed to fill in gaps created by longer life spans, or a safety net for those who had not prepared properly. It was not created to be what it has become --- the retirement program for older America.

The framers of the Social Security program overlooked a fundamental precept of human nature – expectations grow over time, they never diminish. They also may have forgotten another maxim that cleverly sums up the situation we find ourselves in today. “Never look a gift horse in the mouth.” For many years, Social Security was a gift horse, each year paying out more benefits than most recipients paid in, and growing to accommodate (though never adequately) the increasing expectations of an ever growing aging population. It was as if Social Security were an amazing annuity program that older Americans had all purchased. Unfortunately, Social Security is more like a ponzi scheme than an annuity, and by the time we looked this gift horse in the mouth, all of its teeth were badly decayed.

The three legged stool had become unbalanced. While the number of Americans earning private pensions did increase, the number of Americans putting aside significant savings did not. Increasingly, Americans came to expect that Social Security would provide the retirement security that their pensions did not. The role of the individual, once the primary source of retirement security, had instead become the weakest leg.

Enter the Baby Boom

No demographic pattern in the 20th – and now the 21st -- century has had greater long term impact upon our economy and our society than the emergence and aging of the Baby Boom

Generation. According to the 2000 Census, this generation constitutes a little over 30 percent of the population, or 83 million people. By 2011, not even a decade away, millions from this generation will begin collecting their Social Security benefits. The Baby Boomers' arrival at seniority has particular relevancy to the future solvency of the Social Security program for two reasons: their sheer numbers, and their attitude.

Numbers

Social Security operates on a pay-as-you-go basis in which today's payroll tax revenues are used to pay the benefits of today's retirees. This pay-as you-go benefit structure links Social Security's financial health to the ratio of workers paying into the system for each retiree drawing benefits. When the program was implemented, the labor force was more than large enough to cover the benefits of retirees. In fact, the worker-to-retiree ratio was 42-to-1 in 1940. Today, the labor force numbers about 160 million, with a beneficiary population close to 45 million. By the year 2050 there will be twice as many beneficiaries but only 20 percent more workers. More precisely, the worker-to-retiree ratio will dip from today's paltry 3-to-1 to 2.7-to-1 by 2015. By 2030 the ratio will be 2-to-1 and by 2075 it will be 1.8-to-1.

Without radical reform, Social Security's current pay-as-you-go system will devastate the nation's workers and arguably the economy. Expenditures will increase as the Baby Boomers retire and enjoy life expectancies longer than at any other time in our history. Simultaneously, the percentage of the elderly in America will increase, meaning that there will be fewer workers to support each retiree. Assuming that lawmakers choose to leave the pay-as-you-go structure of Social Security intact, their only other options will be to increase payroll taxes, reduce promised benefits, and further raise the retirement age.

Attitude

If the impact caused by the huge numbers of Baby Boomers wasn't bad enough, there is another factor that makes their impact upon Social Security a serious threat to economic stability. The Baby Boomers are the world's finest consumers. They have been groomed literally since birth to expect the best, use it, and then move on. While they arguably are the best educated, best cared-for, most financially successful generation in American history, they are also a generation with impossibly high expectations for what "retirement security" will require. Social Security cannot stretch to meet and fulfill their expectations.

Transforming Dependence into Independence

If anything compels the need for reform, it is changing attitudes about the future reliability of Social Security. Confidence in the program continues to wane each and every year. A full 57 percent of Americans are either "not too confident" or "not at all confident" in the future of the Social Security system. More specifically, 41 percent of Americans do not think that the system will be able to pay benefits when they retire. Most importantly, 63 percent of Americans would allow workers to put a portion of their Social Security payroll taxes into **Private Retirement Accounts** (PRAs) that would be invested in private stocks and bonds.

Generational attitudes paint an even brighter picture for reformers. For Americans 18 to 29 years of age, nearly 80 percent support changing Social Security to give workers the option to

invest a portion of their payroll taxes in the stock market. For the age groups, 30 to 48 and 50 to 64, support decreases to 70 and 50 percent respectively. In addition, many of these same age groups believe that the present Social Security system presents more risk to workers than investing in the stock market. A majority (54 percent) of retired age opposes investment options and finds the stock market riskier.

Changing attitudes in the under-65 age groups about PRAs demonstrate that American workers are ready to take more responsibility for their financial security in retirement. Lawmakers must take these changes in attitude seriously and develop policies that transform dependence on the federal government to independence of the individual worker.

Reform and Its Benefits

The alternative to higher payroll taxes, substantial benefit cuts, and potentially later retirement – not to mention government control – is to encourage workers to take more personal responsibility in preparing for their retirement. The best policy to achieve this aim would be to restructure Social Security from a pay-as-you-go system to an investment-based system in which workers would open a PRA to invest a portion of their payroll taxes in a balanced, secure portfolio of stocks and bonds. These PRAs would operate much like an IRA or 401(k) plan.

One of the keys to fostering personal responsibility is to reward personal initiative. There are numerous advantages to an investment-based Social Security system that benefit both the individual and society:

Rate of Return: The most compelling reason for allowing workers to invest a portion of their payroll taxes in the financial markets is the markedly higher rate of return on investment. Currently, Social Security's rate of return is about 1.2 percent for the average worker. For example, under the current Social Security system and its 1.2 percent return, a 35-year-old machinist with an annual salary of \$33,057 will receive a monthly check of \$1,356 upon retirement at age 67. This same machinist would receive \$6,545 per month if his or her payroll taxes were invested in stocks and bonds that yield a 5.27 percent rate of return.

Private Property Right: A personal retirement account would be a legally protected asset, much like a bank account, IRA, or 401(k). Currently, retirees drawing from Social Security have no legal right to their benefits. In fact, in two major cases, *Helvering v. Davis* (1937) and *Flemming v. Nestor* (1960), the U.S. Supreme Court ruled that individuals have no property or contractual rights to their Social Security benefits. PRAs would be a private property right and appropriately protected by law. Furthermore, property ownership in PRAs would enable workers to pass their assets on to heirs.

National Savings and Economic Growth: An investment-based system would boost America's dismal savings rate and pump wealth-creating capital into the economy. Consider the example and experience of the South American country of Chile, which privatized its public pension system in 1981. As of 1997, the resources administered by the private pension funds totaled \$30 billion – about 43 percent of GDP. Chile's private savings rate is 27 percent of GDP, compared with 4 percent in the United States. The infusion of capital into the private sector is the driving

force behind Chile's extraordinary 7 percent annual economic growth rate – nearly double that of the United States.

Personal Responsibility Also Means Getting Involved

Our lawmakers possess an innate preference for the status quo – unless they are forced by their constituents to divorce themselves from it and march forward with the banner of innovation. Social Security is moving away from being the “third rail of American politics.” Lawmakers and new candidates for elected office can actually mention the idea of letting workers invest a portion of their payroll taxes in the stock market without getting completely discredited.

Given that the American public is beginning to open up to the idea of Social Security privatization, it is important that advocates for reform do whatever they can to counter arguments against empowering individuals to take more control over their retirement destiny. The key is to educate. Write letters to the editor of your local newspaper. If you are a member of a grassroots organization, write an opinion editorial on its behalf. And, by all means, pressure your congressional delegation to craft or support sensible legislation and move forward with this reform.

The window of opportunity to ensure the long-term stability of Social Security is diminishing with every passing year. American workers must wake up from their slumber and begin sounding the clarion call of personal responsibility for retirement security. American workers deserve no less than private retirement accounts.