

MAKING SENSE OF SOCIAL SECURITY REFORM. BY DANIEL SHAVIRO. CHICAGO: UNIVERSITY OF CHICAGO PRESS, 2000.

IS SOCIAL SECURITY BROKE? A CARTOON GUIDE TO THE ISSUES. BY BARBARA R. BERGMANN. ANN ARBOR: UNIVERSITY OF MICHIGAN PRESS, 2000.

ADMINISTRATIVE ASPECTS OF INVESTMENT-BASED SOCIAL SECURITY REFORM. JOHN B. SHOVEN, ED. CHICAGO: UNIVERSITY OF CHICAGO PRESS, 2000.

With more young people believing in UFOs than future returns from Social Security, and exit polls in the November election in Florida showing a slight majority of senior citizens choosing Bush over Gore, it seems that the Bush Campaign 2000 touched the Third Rail of American politics and came away relatively unharmed. The Third Rail aside, the closeness of the election, combined with an eroded Republican congressional majority, means that a significant reform of the current system is unlikely. Given the spirit and specifics of the Bush proposal, that is a good thing.

The *cognoscenti* behind the Bush proposal call their plan “privatization.” Privatization, as typically understood by economists, means the transfer of capital ownership and resource allocation from the state to private individuals or organizations. Social Security is a tax-revenue stream from workers to dependents. Thus true privatization would involve repealing the FICA tax and allowing individuals to save or spend the attendant increase in income however they wished. Is this genuine privatization the vision of the academic-Beltway brain trust behind President Bush’s and others’ proposals for Social Security reform? Or is it their intention to convert the Third Rail into a Third Way? Two recent “pro-privatization” volumes—the first authored by Daniel Shaviro and the second edited by John B. Shoven—will unavoidably lead the thoughtful reader to conclude the latter.

Daniel Shaviro and Barbara Bergmann have written primers on Social Security and its reform. Shaviro, a law professor at New York University, first reviews what he calls “traditionalist” reform proposals favored by Brookings

types such as Henry Aaron. The traditionalist aim is to put the system on firmer financial footing while “preserving its fundamental character.” The aspects of this much-admired “character” include universal coverage, wealth redistribution, and a uniform “benefit package.” Shaviro is bothered by the lack of choice in benefits. He states that the poor and those with no planning ability are worse off compared to financially savvy savers who have a wide choice of supplemental investments. It is telling that these criticisms could also be effectively leveled at universal coverage, but Shaviro is not bothered by this.

The first version of traditionalist reform that Shaviro reviews is that consisting mainly of tax and benefit changes for the purpose of keeping the current system financially afloat. Shaviro does not cite Bergmann, but she clearly falls into this first camp of traditionalists. Bergmann sees the entire “privatization” movement as a conspiracy by Wall Street interests and “folks who hate the idea of the federal government” (p. 52). There is at least a grain of truth to this, like most of the arguments she advances. She seems to be eminent among traditionalists (although not among Democratic propagandists) in her belief that fixing Social Security’s solvency problems through tax-benefit tinkering would be a cakewalk. Although she notes that an increased tax burden would be felt by Generations X and Y (p. 26), she seems quite unconcerned about the “unfairness” of this—although she is quick to play the intergenerational “unfairness” card vis-à-vis “privatization” (p. 70).

The second (and more daring) version of traditionalist reform that Shaviro reviews is represented by Robert M. Ball. Ball advocates that portions of the Social Security Trust Fund be invested in the stock market by the government swapping its debt in open markets for equities. This raises the problem of direct government ownership of private corporations. Unlike even Bergmann, Shaviro is untroubled by the tremendous danger inherent in such a plan. Direct ownership of securities by the federal government should not be too worrisome, he contends, since it should depend on one’s view whether one wants more or less intervention in the economy. In other words, the failures of pure socialism are the stuff of some people’s opinions, not an objective reality per se. One can hardly imagine the average North Korean having the luxury of indulging in such bizarre delusions.

One of the most irritating features of Shaviro’s treatment is his constant attempt to equate government-directed processes to market-directed processes. Two of myriad examples: Increasing the FICA tax could end up “increasing national saving” (p. 103), and individual accounts arguably exist in today’s Social Security system because Social Security tracks individual tax and earnings data (p. 145). The latter is a stunning statement for a law professor, forgetting that in *Flemming v. Nestor* (1960), the Supreme Court ruled that workers have no individual legal right to Social Security.

Opposing privatization’s “opposition to progressive [wealth] redistribution” because it “is not self-evidently correct” (p. 152), Shaviro proposes a

Third Way he calls “progressive privatization.” Unsurprisingly, it includes taxes, “significant limits on consumer choice” of investments (p. 153), “progressive [wealth] redistribution” (p. 153), required purchase of annuities at retirement, and limited inheritability of account balances. This of course is nothing more than a slightly more generous tinkering to the system than that favored by Ball-type traditionalists.

Much more sane and readable is a volume of papers from a 1998 NBER conference on Social Security reform. John B. Shoven, the volume’s editor, notes the advantages of individual Social Security accounts: real assets can build and accumulate over time, unlike the current trust fund, and the increase in personal and national saving implies a higher standard of living for workers in the long run as wealth previously transferred from one generation to another earns a real rate of return from investment.

The fly in the ointment is that 140 million individual accounts will be extremely costly to administer. These huge costs could negate all the advantages of a private system. The first four papers in this volume focus on setting up the least-costly system of individual accounts.

Fred T. Goldberg, Jr., and Michael J. Graetz seek to keep costs down by suggesting that the new system administering the individual accounts be built on the foundation of the current wage-reporting, payroll-tax schemes to collect funds and track account accruals. This new structure, built on the old system, would add little in terms of additional costs. This saves costs on the collection and clerical side. What is the answer to investment and distribution? A simple, no-frills collection of private funds selected by the government. Other private mutual funds offering a wider range of services and investment selections would be authorized to compete with the basic government plan. Goldberg and Graetz amusingly believe that the government plan would provide a competitive “discipline” to the ancillary private plans.

Sylvester J. Schieber and John B. Shoven look at privatized and partially privatized Social Security systems in Chile, Australia, Britain, and Sweden for guidance and insight. Proving that administrative costs are comprised of a high proportion of fixed costs, the twenty-seven-year-old system in Australia had average administrative costs of 0.8 percent in 1997, with costs steadily decreasing as the average account’s size increases. Schieber and Shoven believe this augurs well for the U.S., given the much more developed and competitive nature of U.S. capital markets. To keep record-keeping costs down, Schieber and Shoven advocate the establishment of a PSA (personal security account) Central run by the Social Security Administration or a private firm under contract management. Echoing Goldberg and Graetz, they advocate the establishment of a low-risk, no-frills government plan operating alongside other more risky plans with various investment bells and whistles.

Estelle James, Gary Ferrier, James Smalhout, and Dimitri Vitas compare the costs of three alternative systems. The first consists of individual accounts

invested in the retail market (à la 401[k]s); the second consists of individual accounts invested in the institutional market, with limits on choice among fund companies; and the third consists of no individual accounts but a large central pool of funds invested in the institutional market. Using an econometric model, James et al. find that under the retail alternative, investors benefit from economies of scale but face high marketing costs. The last alternative (central pool of funds) is the least costly, achieving economies of scale sans marketing but eliminating worker choice of investments. It is also subject to politicized allocations of capital. The second choice, individual accounts institutionally invested, seems to be the Goldilocks “just right” to James et al., since it allows worker choice, involves economies of scale without high marketing costs, and doesn’t run the risk of politicized investment.

Peter Diamond champions something similar to the pool of funds proposal of James et al. because of the supposed cost advantage. Using the federal employees’ Thrift Savings Plan (TSP) as his guide, contributions of 2 percent of earnings would have average administrative costs of 0.4-0.5 percent of assets per year over a forty-year working career. Based on his analysis of Chile and U.S. mutual funds, he concludes that the cost of private accounts would be at least twice as high.

Shoven, the editor, admits that “[n]one of the papers evaluates a completely unregulated, fully private system for cost and, presumably, other reasons” (p. 6). This is sensible in light of the fact that evaluation of such a system obviates the pretense of the volume (i.e., solving the “problem” of high costs). It signifies that the authors have painted themselves into a flimsy logical box. Embracing universal forced saving guarantees a centralized government scheme. It then comes as no surprise that, assuming centralization, the government emerges as the most cost-effective administrator—thus the complete logical circularity of the papers in this volume. Wryly amusing are the contortions undertaken by analysts with market predilections to derive market-dominated systems from statist assumptions. Sad will be the consequences if these disasters are ever implemented.

There is much sanctimonious grandstanding about one benefit of “privatization”: offering workers a choice in terms of asset holdings. But this is a selective advocacy of choice, since choosing to opt out of the system entirely is denied. Hence, those with high time preferences for consumption (including most of the underclass poor with shorter average life expectancies) are made worse off under forced saving. This is exactly where the Third Way house of cards collapses. It finds problems to solve in its paternalistic box, but it can’t find a consistent justification for the box itself. As Lord Francis Jeffrey said after reading Wordsworth, “This will never do.”

DALE STEINREICH
SOUTHWEST BAPTIST UNIVERSITY