

SOCIAL SECURITY PRIVATIZATION IN OTHER COUNTRIES—WHAT LESSONS CAN BE LEARNED FOR THE UNITED STATES?

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Since the beginning of its second term in office, the Bush administration has pushed for Social Security reform. One of the most significant—and controversial—aspects of the administration’s plan is the creation of “private accounts,” which would allow workers to channel part of their payroll taxes to the private investment market and to manage these investments themselves. In this article, Ms. Tedrow surveys the privatization of social security systems in other countries. Ms. Tedrow compares the

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structure and implementation of privatization in Chile, the United Kingdom, Sweden, and Australia, and discusses the relative success or failure of privatization in terms of the cost to finance the transition, total savings at retirement, administrative costs, the impact on the safety net for the poor, and other factors. Ms. Tedrow also suggests some alternative ways to strengthen the current Social Security system. Ms. Tedrow's analysis of the experience of other countries is informative and relevant in light of the recently proposed changes to the American system.

I. Introduction

Old age is at once the most certain, and for many people the most tragic, of all hazards. There is no tragedy in growing old, but there is tragedy in growing old without means of support.

—President Franklin D. Roosevelt, November 14, 1934

In his February 2, 2005, State of the Union address, President Bush called for privatization of the U.S. Social Security system,¹ which is under pressure to address significant future solvency issues.² The U.S. Social Security system is a pay-as-you-go (PAYGO) system, as are the social security systems of most nations.³ In this system, retiree liabilities are paid out of the taxes on the earnings of the currently employed.⁴ A March 2005, report by the nonpartisan Congressional Budget Office (CBO) projects that tax revenues will fall below program outlays in the year 2020 and that the Trust Fund will be exhausted in 2052; after that time, dedicated revenues will only pay 70–78% of benefits.⁵ Later, it is projected that benefits will continue to be paid out, but at a lesser rate, i.e., 70–75%.⁶ Most experts agree that in order for Social Security to remain solvent for the long term, three alternatives are available: raise the retirement

1. Strengthening Social Security Permanently, at 1, <http://www.whitehouse.gov/infocus/social-security/200501/socialsecurity2.pdf> (last visited Jan. 23, 2006).

2. CONG. BUDGET OFFICE, UPDATED LONG TERM PROJECTIONS FOR SOCIAL SECURITY (2005), <http://www.cbo.gov/showdoc.cfm?index=6064&sequence=0>.

3. William Poole, President, Fed. Reserve Bank of St. Louis, Demographic Challenges to State Pension Systems Around the World, Speech at Culver-Stockton College (Feb. 24, 2005), http://www.stlouisfed.org/news/speeches/2005/2_24_05.html (last visited Jan. 23, 2006).

4. *Id.*

5. CONG. BUDGET OFFICE, *supra* note 2. Note however that the Social Security Board of Trustees reported in March 2005 that program outlays will exceed tax revenues in 2017 and that the Trust Fund will be exhausted in 2041 and no longer able to pay out 100% of benefits.

6. *Id.*

age,⁷ cut benefits, raise taxes,⁸ or some combination of the three.⁹ Prudence certainly dictates that action should be taken to address the challenges posed by the financial outlook for Social Security. This action should be carefully considered, however, in light of the lessons available to us from other nations that have faced similar challenges and after taking into account the complex purposes of the American Social Security system.

II. The President's Proposed Reform

A. Administration's Proposal

The partial privatization model that the administration proposes is voluntary and would be established gradually, eventually permitting all workers to set aside 4% of their Federal Insurance Contribution Act (FICA) payroll taxes to a private retirement account (PRA) that will be a vested interest owned by the individual.¹⁰ In fact, President Franklin D. Roosevelt, in a 1935 address to Congress, proposed the idea of private accounts¹¹ by suggesting that a pillar of the Social Security system include “voluntary contributory annuities by which individual initiative can increase the annual amounts received in old age.”¹² Under the current administration's proposal, contributions will initially be capped at \$1000 per year, and the cap will be gradually raised over time.¹³ The individual will be free to choose from a limited menu of low-cost equity and fixed-income mutual funds, based on the model of the Federal Thrift Savings Plan (TSP).¹⁴ Distributions would be annuitized and any undistributed balance would be available to pass on to heirs after death.¹⁵ Similar to

7. Poole, *supra* note 3.

8. *See, e.g., id.*

9. CONG. BUDGET OFFICE, *supra* note 2.

10. Personal Retirement Accounts, at 5, <http://www.whitehouse.gov/infocus/social-security/200501/socialsecurity3.pdf> (last visited Jan. 23, 2006).

11. This article will use the term “private accounts” because this term has traditionally been used to refer to the changes proposed to the Social Security system. As explained below, the proposed reforms would allow part of a worker's social security savings to be invested in the private market. Social security savings have always been and will continue to be “personal.” *See* Fairness and Accuracy in Reporting, Private vs. Personal: Media's Social Security Semantics, <http://www.fair.org/index.php?page=2039> (last visited Jan. 23, 2006).

12. Poole, *supra* note 3.

13. Personal Retirement Accounts, *supra* note 10, at 5.

14. *Id.* at 6.

15. *Id.* at 7–8.

qualified pension plans and individual retirement accounts, PRAs would grow tax-free until distribution, at which time they would be subject to ordinary income tax treatment.¹⁶

B. Potential Issues

The proposed transition presents a variety of issues to individuals and to American society, including the massive dollar cost to fund the current beneficiaries and convert to a private account system, variously estimated between hundreds of billions to over a trillion dollars. For example, the Office of Management and Budget estimates that the transition to a private account system will require \$754 billion over the next ten years.¹⁷ However, note that diversion of four percentage points of earnings tax would worsen the Social Security Fund's ability to pay out benefits for the term projected by both the Trustees and the Congressional Budget Office (CBO) and result in the Fund going broke in 2020, creating the very crisis that the administration seeks to avoid.¹⁸ To avoid such a debacle, alternatives are to either cut benefits, raise taxes, or borrow up to \$2 trillion over the next ten years to facilitate the transition.¹⁹

Other issues include the question of the ability of unsophisticated individual investors to make prudent choices in managing their accounts, the variable performance of the stock market, the question of the impact of the removal of a dependable retirement income floor to the poor, the potential inequitable impact on women and minorities due to reduced earnings and intermittent participation in the workforce,²⁰ and the conflicts that may arise as a result of the government's increased alignment with the financial prospects of corporations. One expert has noted that the selection process for financial service providers, "puts the issue of potential corruption, collusion, and rent-seeking in the center."²¹ Moreover, the nonretirement aspects of Social Security (such as survivors' and

16. Thrift Savings Plan Background, at 9, <http://www.whitehouse.gov/infocus/social-security/200501/socialsecurity4.pdf> (last visited Jan. 23, 2006).

17. Personal Retirement Accounts, *supra* note 10, at 8.

18. Editorial, *Paying for Private Accounts*, DENVER POST, Apr. 5, 2005, at B-06.

19. *Id.*

20. See WILLIAM SPRIGGS, ECON. POLICY INST., SOCIAL SECURITY PRIVATIZATION'S MOTHERHOOD PENALTY, http://www.epinet.org/content.cfm/webfeatures_snapshots_20050202 (last visited Jan. 23, 2006).

21. PETER A. DIAMOND, SOCIAL SECURITY REFORM 25 (2002).

disability benefits) constitute another significant issue.²² Retired workers constitute only 63% of the people now drawing benefits from Social Security.²³ The remaining 37% consist of survivors of deceased workers and retirees (15%) disabled workers (11%), and dependents of retired and disabled workers (11%).²⁴

In addition, a substantial issue to note with regard to President Bush's proposed privatization plan is that it fails to address the core issue with Social Security—that is, its long-term solvency necessary to pay out promised benefits. Supporters dismiss this issue by characterizing the funding problem as simply the catalyst for reform, and asserting that the nation should take this opportunity to change the retirement system in a fundamental way.²⁵ Note, however, that according to the International Monetary Fund, the administration's proposal to permit diversion of Social Security contributions into PRAs poses significant fiscal challenges, and any such instruments “should be coupled with other measures that assure the long-run solvency of the Social Security system.”²⁶

Privatization in other countries, and as proposed in the United States, shifts the burden of retirement saving to the individual, which is analogous to defined contribution qualified plans. Privatization may or may not provide the level of retirement benefits to individuals that the current social security system does. Recently, the administration added two features to its proposed plan. The first is the concept of a means testing progressive indexation, whereby benefits will be paid out on a sliding scale of income, which will result in benefit cuts to those earning as little as \$20,000.²⁷ The other feature

22. See Saul Friedman, *Gray Matters: Social Security Changes May Also Hurt Children*, NEWSDAY, Apr. 2, 2005, at B06 (citing William E. Spriggs, senior fellow with Washington's Economic Policy Institute, who cautions that privatization threatens the security of children “by changing the focus of the program from assuring American parents that their children will be protected from economic calamity if the parent becomes disabled, dies or lives long enough to avoid being a burden on their children to being solely an individual savings vehicle for retirement”).

23. *Questions About Privatization*, DENVER POST, Mar. 25, 2005, at B-06.

24. *Id.*

25. N. Gregory Mankiw, *Personal Dispute—Why Democrats Oppose Bush*, NEW REPUBLIC, Mar. 21, 2005, at 18.

26. INT'L MONETARY FUND, 2005 ARTICLE IV CONSULTATION WITH THE UNITED STATES OF AMERICA, CONCLUDING STATEMENT OF THE IMF MISSION, <http://www.imf.org/external/np/ms/2005/052505a.htm> (last visited Jan. 23, 2006).

27. John Podesta, Ctr. for Am. Progress, *Progressive Indexation*, <http://www.americanprogress.org/site/pp.asp?c=biJRJ8OVF&b=687435> (last visited Jan.

calls for shifting the indexation of benefit increases from wage indexing to price indexing to reduce the cost of benefits.²⁸ Wages generally rise faster than prices, and shifting to a price index will result in significant benefit cuts.²⁹ According to the Social Security actuaries, Social Security benefits currently equal 42% of the earnings of an average wage earner who retires at age sixty-five.³⁰ This percentage is projected to decline to 36% over the next two decades, as Social Security's "normal retirement age"³¹ rises to sixty-seven and would remain at 36% thereafter.³² Under the price indexation proposal, a worker born in 1977 who earned average wages throughout his or her career and retired at age sixty-five in 2042 would receive monthly Social Security benefits 26% lower than under the current benefit structure.³³

C. Social Security Rights

Although the issue of Social Security privatization has not been presented to the courts in the United States, the related question of a worker's entitlement to Social Security, and its characterization as insurance, was addressed by the Supreme Court in a 1960 case entitled *Flemming v. Nestor*.³⁴ The majority of Justices in that case held that workers have no legal right to a return on the payroll taxes paid into Social Security; those taxes are not insurance premiums and the government is free to cut or eliminate the program and its benefits at any time, regardless of a worker's contributions.³⁵ "Congress included in the original act, and has since retained a claim expressly reserving to it the right to alter, amend, or repeal any provision of the

23, 2006); see also Jason Furman, Ctr. on Budget & Policy Priorities, An Analysis of Using "Progressive Price Indexing" to Set Social Security Benefits, <http://www.cbpp.org/3-21-05socsec.htm> (last visited Jan. 23, 2006).

28. ALICIA H. MUNNELL & MAURICIO SOTO, CTR. FOR RETIREMENT RESEARCH AT BOSTON COLL., WHAT DOES PRICE INDEXING MEAN FOR SOCIAL SECURITY BENEFITS, http://www.bc.edu/centers/crr/facts/jtf_14.pdf (last visited Jan. 23, 2006).

29. *Id.* at 2 figs.1, 4.

30. Robert Greenstein, Ctr. on Budget & Policy Priorities, So-Called "Price Indexing" Proposal Would Result in Deep Reductions over Time in Social Security Benefits, http://www.cbpp.org/12-17-04socsec.htm#_ftn1 (last visited Jan. 23, 2006).

31. See 29 U.S.C.A. § 1002(24) (West 2005) (defining "normal retirement age").

32. Greenstein, *supra* note 30.

33. *Id.*

34. 363 U.S. 603, 608-11 (1960).

35. *Id.*

act.”³⁶ Moreover, “eligibility for benefits . . . [does] not in any true sense depend on contribution through the payment of taxes”³⁷ Clearly, Congress is free to amend the Social Security program to provide for privatization or any other features it deems fit and politically sustainable.

D. Politics of Privatization

The topic of privatization of Social Security has received considerable political attention in the last several months, and a national debate is playing out in the media on both sides of the issue. President Bush established a “war room” in spring 2005 and concluded an extensive national tour, “60 Stops in 60 Days,” as part of a public relations campaign to promote the proposal.³⁸ USA Next,³⁹ an organization funded by conservative supporters, backs the proposal in national advertising,⁴⁰ and the American Association of Retired Persons⁴¹ (AARP) is also bringing its considerable influence to bear in opposition to the proposal.⁴² Editorials, newspapers, and magazines are all weighing in on the issue as well.⁴³ Two state legislatures (Hawaii and New Jersey) have passed resolutions urging their congressional delegations to oppose President Bush’s proposal.⁴⁴ The privatization discussion is, in many ways, based on two separate, but important analyses: the economic and legal analysis, and the philosophical and political views of social security and its role in American society.⁴⁵ The two are inextricably intertwined.

36. *Id.* at 610–11.

37. *Id.* at 609.

38. OFFICE OF PUB. AFFAIRS, U.S. DEP’T OF THE TREASURY, *60 Stops in 60 Days*, in STRENGTHENING SOCIAL SECURITY (2005), <http://www.strengtheningsocialsecurity.gov/60stops/>.

39. USA Next, <http://www.usanext.org/index.cfm> (last visited Jan. 23, 2006).

40. Press Release, USA Next, Seniors Pound ‘Political Fear Mongers’ with Nationwide TV & Radio Ads (Oct. 27, 2004), http://www.usanext.org/Press_Story.cfm?Press_Article_ID=191 (last visited Jan. 23, 2006).

41. Am. Ass’n of Retired Persons, Online Bulletin on Social Security, <http://www.aarp.org/bulletin/socialsec/> (last visited Jan. 23, 2006).

42. See generally AARP, Social Security: Where We Stand, http://www.aarp.org/bulletin/socialsec/ss_where_we_stand.html (last visited Jan. 23, 2006).

43. See generally Editorial, *Hitting the Middle Class, Again*, N.Y. TIMES, May 3, 2005, at A24; Editorial, *Social Security in Flux at 70; Debate Shifts from Solvency to GOP’s Plan for Accounts*, WASH. POST, Aug. 14, 2005, at A01.

44. H. Con. Res. 290, 2005 Leg., 23d Sess. (Haw. 2005); Assemb. J. Res. 121, 2004 Leg., 211th Sess. (N.J. 2005).

45. See DIAMOND, *supra* note 21, at 1–2.

III. Other Nations—Models or Warnings?

In recent years, more than thirty countries have begun prefunding their social security plans with some form of partial or fully privatized accounts,⁴⁶ with a variety of models or features: mandatory versus voluntary, full or limited investment choices, with a varying degree of regulation in place. It is sometimes difficult to decipher the actual practices of different countries, and much of the published material found discussing the structure of a privatized social security program emphasizes the variance in policy and procedure from one country to the next. Because of the multiple variations and complexities in the different countries' plans, this article focuses on four major nations: Chile, the United Kingdom, Australia, and Sweden, and it provides information about their Social Security structures and the relative successes or failures they have experienced and how their systems might compare to the United States.

Chile in particular is frequently touted by supporters as a model of Social Security privatization. The United Kingdom, a nation with a more similar economy and social culture to the United States, is also often cited as another leader in the privatization effort. Australia and Sweden have also initiated privatization plans and are similarly more developed nations.

Differences between Latin American countries and the United States include widely differing political systems when privatized Social Security was instituted (dictatorship versus democracy), and different economies (weak emerging capital markets versus well-established capital markets and economy).⁴⁷ Similarities between the United States and other countries that have instituted privatized Social Security structures include demographics (falling birth rates and rising numbers of elderly people)⁴⁸ and a realization that the pay-

46. Soc. Sec. Admin., Frequently Asked Questions About Social Security's Future, <http://www.ssa.gov/qa.htm> (last visited Jan. 23, 2006). See generally Robert Palacios & Montserrat Pallarès-Miralles, *International Patterns of Pension Provision*, in SOCIAL PROTECTION DISCUSSION PAPER SERIES, Apr. 2000, available at <http://siteresources.worldbank.org/SOCIALPROTECTION/Resources/SP-Discussion-papers/Pensions-DP/0009.pdf> (giving detailed description of several countries' social security plans).

47. See Silvia Borzutzky, *Privatizing Social Security: Relevance of the Chilean Experience*, in ALTERNATIVES TO SOCIAL SECURITY, AN INTERNATIONAL INQUIRY 85-87 (James Midgley & Michael Sherraden eds., 1997).

48. Poole, *supra* note 3.

as-you-go system that most countries have adopted cannot sustain the level of promised payouts without some type of reform.⁴⁹

A. Chile

In 1981, Chile terminated their PAYGO system and mandated that new workers contribute 10% of their wages to private accounts managed by six *Administradoras de Fondos de Pensiones* companies (AFPs).⁵⁰ No employer contributions are required. Chile's sweeping social security reforms were the product of General Augusto Pinochet's dictatorial regime that suppressed freedom of expression and dissent and had complete control of all branches of the government.⁵¹ Workers entering the labor force after December 31, 1982, were required to join the new system.⁵² Older workers were enticed to switch to the new system with a variety of incentives, including: "recognition bonds" for their service/participation in the old system, increased current income through reduced withholding,⁵³ fear of loss of pension rights under the old social insurance system, employer pressure, and, finally, an expensive and well-planned propaganda campaign.⁵⁴ Participation for the self-employed is voluntary, and many rural Chileans and those working in the underground economy do not participate at all.⁵⁵ Pinochet's junta ensured that the military was excluded from the new privatized system as the law protected and preserved the existence of a privileged pension fund for the military, as well as railroad employees and other public sector employees.⁵⁶

49. *Id.*

50. Decree Law No. 3500 was published in November 1980. It restructured the Social Security system then existing in Chile and established a new system of privatized pensions for retirement, disability and survivorship. See Superintendencia de Administradoras de Fondos de Pensiones, The Individual Capitalization System, http://www.safp.cl/INGLES/sist_previsional/cont1_sistema_ing.html (last visited Jan. 23, 2006). This website provides text of Decree Law No. 3500 in Spanish and an explanation of the system in English.

51. Borzutzky, *supra* note 47, at 75.

52. OFFICE OF POLICY, SOC. SEC. ADMIN., SOCIAL SECURITY PROGRAMS THROUGHOUT THE WORLD: THE AMERICAS, 2003, 61, available at <http://www.ssa.gov/policy/docs/progdsc/ssptw/2002-2003/americas/ssptw03americas.pdf>.

53. Marla Dickerson, *A Personal Burden; Chile Switched to a Privatized Pension System Nearly 25 Years Ago, and Millions of Workers Still Fall Through the Cracks*, L.A. TIMES, Feb. 13, 2005, at C1.

54. Borzutzky, *supra* note 47, at 81.

55. Dickerson, *supra* note 53; Larry Rohter, *Chile's Retirees Find Shortfall in Private Plan*, N.Y. TIMES, Jan. 27, 2005, at 1, available at <http://www.globalaging.org/pension/us/socialsec/2005/chile.htm>.

56. OFFICE OF POLICY, *supra* note 52, at 61.

At first blush, privatization appears to have delivered significant fiscal benefits. For example, Chilean workers have saved more than \$60 billion in private accounts, approximately two-thirds of the nation's GDP, and, average returns on investments have been impressive, topping 10%.⁵⁷ Also, before privatization, Chile operated under a disparate patchwork of pension systems that were mismanaged, financially unsustainable and corrupt, favoring those with political clout.⁵⁸

Upon closer examination, however, a number of issues emerge. For example, even though as noted above, average returns have topped 10% since inception, average returns were negative 2.5%, 3.5%, 4.7%, and 1.1% for the years 1995 to 1998, respectively.⁵⁹ In response to this trend, the Chilean government encouraged workers to delay retirement until the financial outlook improved.⁶⁰ Also, because of Chile's large rural population, seasonal workers and a teeming black market, half the population of the country does not contribute to the Social Security program.⁶¹ Sixty percent of Chilean participants have saved less than \$3500, and millions of workers have not saved enough to qualify for the minimum pension.⁶² Hundreds of thousands of Chileans facing retirement are finding that they would have benefited more from the old system because of the way their recognition bonds were calculated.⁶³ High management fees, estimated at 25% or more, have trimmed payouts,⁶⁴ and many poor Chileans are falling through the safety net and may be facing old age in poverty. In fact, many experts are concerned that a large proportion of Chile's population will face extreme poverty after retirement.⁶⁵

As of last year, eleven other Latin American countries have followed Chile's model of privatization, but have experienced much less success than Chile. The World Bank, once an enthusiastic privatiza-

57. Dickerson, *supra* note 53.

58. *Horror Movies? Not Really; Other Countries' Pension Policies*, ECONOMIST, Feb. 12, 2005, at 26.

59. Pia Lopez, *Retirement Realities, Other Nation's Programs Show Great Risks*, SACRAMENTO BEE, Feb. 13, 2005, at E1.

60. *Id.*

61. Rohter, *supra* note 55, at 1.

62. Dickerson, *supra* note 53.

63. *Id.*

64. Rohter, *supra* note 55, at 1.

65. Borzutzky, *supra* note 47, at 84; *see also* Greg Anrig Jr., Vice President of Programs, The Century Found, *No Way, José!*, (Dec. 7, 2004) <http://www.socsec.org/commentary.asp?opedid=799>.

tion proponent, noted in a recent report that in Chile and other Latin American countries that have adopted the Chilean model, more than half of all workers have no safety net during their old age.⁶⁶ That report further noted that the “failure to extend access to formal financial protection for old age to a broader segment of society has been a major disappointment.”⁶⁷

Chile’s pioneering privatization of the Social Security system resulted in positive effects for the Chilean economy and the government budget, but its lack of coverage of old age pensioners⁶⁸ and high administrative costs⁶⁹ can hardly be characterized as a success.⁷⁰ In addition, lack of participation by many rural Chileans and those who work in the underground economy raises significant concerns regarding old age poverty in Chile.⁷¹ Chile’s prior social security system was corrupt and inefficient; however, the U.S. Social Security system is very efficient and low cost.⁷² In 2003 the U.S. expenditure on Social Security was 4.3% of the GDP.⁷³

Chile was relatively successful in establishing privatization because military dictator General Augusto Pinochet dramatically increased Chile’s budget surplus to fund transition costs through forced sale of state-owned assets and privatization of government services, enabling the drive-up in the capital markets and payment streams to

66. Anrig, *supra* note 65.

67. Press Release, The World Bank, Keeping the Promise of Social Security in Latin America: Greater Access to Pensions Is Needed to Prevent Poverty in Old Age (Dec. 13, 2004), <http://wbln1018.worldbank.org/LAC/LAC.nsf/ECADocbyUnid/146EBBA3371508E785256CBB005c29B4?Opendocument>.

68. INDERMIT GILL, TRUMAN PACKARD & JUAN YERMO, THE WORLD BANK: KEEPING THE PROMISE OF OLD AGE INCOME SECURITY IN LATIN AMERICA 273–74 (2005).

69. Klaus-Jürgen Gern, *Recent Developments in Old Age Pension Systems: An International Overview*, in SOCIAL SECURITY PENSION REFORM IN EUROPE 439, 472 (Martin Feldstein & Horst Siebert eds., 2002); *see also* Rohter, *supra* note 55, at 1.

70. Borzutzky, *supra* note 47, at 88–89.

71. GILL, PACKARD & YERMO, *supra* note 68, at 170.

72. *Talk of the Nation: Social Security in the U.S. and Other Nations* (NPR radio broadcast, Feb. 8, 2005) (referring to comment by Jonathan Gruber), <http://www.npr.org/templates/story/story.php?storyId=4490786>.

73. BD. OF TRS., FED. OASDI TRUST FUNDS, THE 2004 ANNUAL REPORT OF THE BOARD OF TRUSTEES OF THE FEDERAL OLD-AGE AND SURVIVORS INSURANCE AND DISABILITY INSURANCE TRUST FUNDS 2 (2004), *available at* <http://www.ssa.gov/OACT/TR/TR04/tr04.pdf> [hereinafter TRUSTEES 2004 REPORT]. Costs for 2005 are similarly calculated by the Social Security Administration at 4.3% of the Gross Domestic Product. BD. OF TRS., SOC. SEC. AND MEDICARE TRUST FUNDS, A SUMMARY OF THE 2005 ANNUAL REPORTS (2005), <http://www.ssa.gov/OACT/TRSUM/trsummary.html>.

retirees.⁷⁴ The United States, on the other hand, has a difficult time maintaining a balanced budget; the deficit was over \$8 trillion as of March 2006,⁷⁵ and transition financing for privatization is projected to incur another \$1–2 trillion in debt.⁷⁶ Moreover, shortly after the introduction of private accounts, Chile endured a financial crisis that precipitated high interest rates, which helped AFP funds that were invested in debt. As rates fell in ensuing years, bond prices were elevated, which in turn resulted in large capital gains.⁷⁷ The funds further prospered as a stock rally boosted equity investments in the 1980s and 1990s.⁷⁸ The current U.S. economy is situated very differently from Chile's at the time Chile adopted privatization. U.S. interest rates continue to hover near record lows, and while Chile's then-promising market was on the threshold of an expansionary boom, the United States is a mature and established market that saw recent, significant positive growth for over twenty years beginning in 1982.⁷⁹ Because of the well-developed nature of the American economy and the high efficiency of the current Social Security system, it is doubtful that the U.S. economy will experience any "lift" similar to that of Chile.

When examining the applicability of the Chilean model to the United States, it is important to stress the uniqueness of the Chilean experience. Social Security privatization in Chile took place not only under an extremely authoritarian regime, but also as part of a revolutionary reordering of the relationship between the state and society. Both the regime and the policy-making process were undemocratic and totalitarian, and those affected by the policy decisions were excluded from the decision-making process. The United States is a pluralistic, democratic society, and the Social Security system enjoys a

74. *Morning Edition: Examining Private Account Pensions in Chile* (NPR radio broadcast, Apr. 7, 2005) (referring to comments by Kathleen Schalch), <http://www.npr.org/templates/story/story.php?storyId=4580360>.

75. BUREAU OF PUB. DEBT, DEP'T OF TREASURY, *THE DEBT TO THE PENNY AND WHO HOLDS IT* (2006), <http://www.publicdebt.treas.gov/opd/opdpdodt.htm>.

76. Stephanie A. Kelton, *Entitled to Nothing: Why Americans Should Just Say 'No' to Personal Accounts* 15 (Univ. of Mo., Kansas City, Dep't of Econ. & Ctr. for Full Employment & Price Stability, Working Paper No. 40, 2005), available at <http://cfeps.org/pubs/wp-pdf/WP40-Bell.pdf> (last visited Jan. 23, 2006).

77. Bob Davis & Matt Moffett, *From Nations That Have Tried Similar Pensions, Some Lessons*, WALL ST. J., Feb. 3, 2005, at A1.

78. *Id.*

79. *Id.*

broad base of public support. The economic, administrative, and social effects of privatization in Chile have not been favorable, despite claims to the contrary. According to Silvia Borzutzky, political scientist and expert on Chilean Social Security, “the negative lessons of the Chilean privatization . . . [should] serve as a warning to those who believe . . . privatization of collective provision will enhance the well being of the people.”⁸⁰

B. The United Kingdom

The nearly total privatization model in Chile has received extensive study and publicity as a model for reform. It may, however, be more instructive to learn from the experiences of the United Kingdom. The British and the Americans share not only a common cultural heritage, but the British experience is more relevant to that of a large developed economy. It also involves partial, rather than complete, privatization of the public system, which is more similar to the Bush administration’s proposal.

Britain’s Social Security system dates back to the nineteenth century and was enacted based on the overriding principle that individuals should be insured “against the contingency of their growing old and being unable to earn a living.”⁸¹ The British pension system is the most reliant on private finance of any high-income country. It is also the most complicated. In simple terms, the British system is based on two tiers. The first tier, introduced in 1908, is mandatory and provides a basic flat-rate weekly benefit, which is independent of earnings; it is financed on a PAYGO basis.⁸² The level of benefit from this basic pension ensures very low (poverty level) benefits. The second tier, introduced in 1961, provides earning related benefits from either public or private pensions.⁸³

As a practical matter, the second tier was the first phase of privatization because it gave employers the option not to participate in the *public* portion of the second tier, and instead, establish a *private*

80. Borzutzky, *supra* note 47, at 88–89.

81. Matthew Owen & Frank Field, *Pension Reform in Britain: Alternative Modes of Provision*, in ALTERNATIVES TO SOCIAL SECURITY: AN INTERNATIONAL INQUIRY 94 (James Midgley & Michael Sherraden eds., 1997).

82. Lillian Liu, *Retirement Income Security in the United Kingdom*, 62 SOC. SEC. BULL. 23, 25 (1999), available at <http://www.ssa.gov/policy/docs/ssb/v62n1/v62n1p23.pdf>.

83. *Id.* at 25–26.

second tier known as an “occupational pension,” otherwise known as “contracting out.”⁸⁴ In 1978, the government introduced the State Earnings Related Pension Scheme (SERPS), which improved the second-tier public pension by replacing a higher percentage of contributed earnings.⁸⁵ Upon retirement, workers would receive either a small, first-tier pension, plus a second-tier pension through SERPS, or a small, first-tier pension, plus an employer-sponsored occupational pension.⁸⁶ Under both scenarios, defined benefit plans provided protection for workers.⁸⁷ Transition costs were financed by general revenue (including debt) and by reduced benefits in the government system.⁸⁸

In 1988, the British government allowed workers to voluntarily opt out of either the public SERPS or the employer-sponsored occupational pension and set up tax-deferred individual accounts, called “appropriate personal pensions” (APPs).⁸⁹ Those who opted out would then draw their small, first-tier pension in addition to whatever their private accounts provided when annuitized.⁹⁰ Over three million people opted out of the SERPS during the first year, and by the end of the fifth year, another 2.3 million people had opted out and created APPs.⁹¹ To promote contracting out, the government pledged not only a rebate from payroll contributions (National Insurance), but also a tax relief on the rebate, as well as an incentive bonus: 2% of payroll for the first five years, and 1% from 1993–1996 thereafter for those aged thirty or older.⁹²

The British experience appears to have been favorable for the government budget. The percentage of governmental expenditure on state pension spending in Great Britain accounted for only 4.3% of the GDP in 2000 and is expected to decline to 3.4% by 2050.⁹³ However,

84. *Id.* at 25–27.

85. *Id.* at 27.

86. *Id.*

87. Kelton, *supra* note 76.

88. *Social Security Privatization: Experiences Abroad*, at 3, CBO Testimony Before the Comm. on Ways and Means, U.S.H.R. (Feb. 11, 1999) (statement of Dan L. Crippen, Director Cong. Budget Office), <http://www.cbo.gov/showdoc.cfm?index=1080&sequence=0>.

89. Liu, *supra* note 82, at 26.

90. *Id.* at 28.

91. *Id.*

92. *Id.* (citing PHILIP E. DAVIS, PRIVATE PENSIONS IN OECD COUNTRIES—THE UNITED KINGDOM 13 (1997)).

93. *Id.* at 31 tbl.2.

the relatively low level of U.K. public pension liability does not fully reflect the extent of public funding. The government supplements pensioners' heavy reliance on means-tested benefits with a broad array of social insurance programs, including the National Health Insurance, to give all pensioners access to free medical care.⁹⁴ On the other hand, compare the U.S. expenditure on Social Security benefits, which was 4.3% of the GDP⁹⁵ in 2004 and, as noted above, is widely regarded as an extremely efficient and low-cost system.

In 1990, the British National Audit Office publicly reported that the cost of contracting out of SERPS for personal pensions had significantly exceeded predictions and resulted in staggering costs that dwarfed expected program savings.⁹⁶ These costs included the contribution rebates, tax savings to APP account holders on the amounts of the rebate, and the incentive payments.⁹⁷ Later, in 1997, the Department of Social Security estimated that the net present value of future SERPs expenditure savings contracting out to personal pensions during 1987–1995 was £7.2 billion.⁹⁸ Contribution rebates and incentives totaled £21.7 billion, and income tax relief for contribution rebates to APPs amounted to another £2 billion between 1987 and 1995.⁹⁹ In other words, the cost of the APPs was more than triple the savings.¹⁰⁰

Similar to the Bush administration's proposal, the introduction of APPs was promoted as a way to ensure fiscal soundness and to provide consumer choice in investments. Unfortunately, the British system was dogged by a "mis-selling" scandal, where insurance company salespeople persuaded workers to switch out of their workplace plan to APPs, promising large payouts, even when it was wholly inappropriate for the individual.¹⁰¹ These salespeople often charged "not only an initial fee, but also an annual fee on invested funds and a monthly flat fee . . . indexed according to price or wage

94. *Id.* at 43 n.63. Note also that unlike the United States, Social Security in Britain refers to a broader array of social insurance programs and means-tested social assistance as well as universal social allowances; in the United States, Social Security refers exclusively to old age retirement, survivors, and disability insurance programs. *See id.*

95. TRUSTEES 2004 REPORT, *supra* note 73, at 11.

96. Liu, *supra* note 82, at 34.

97. *Id.*

98. *Id.*

99. *Id.*

100. *Id.*

101. *Id.* at 35.

increases,”¹⁰² in some cases amounting to more than 20% of contributions.¹⁰³

In 1992 an audit of a random sample of accounts by the Securities and Investment Board, found that “a staggering percentage of pensions had been sold to those who would be worse off in retirement as a result.”¹⁰⁴ British regulators responded with a crackdown in the 1990s, and insurers were required to compensate customers whose accounts had performed more poorly by switching to APPs.¹⁰⁵ As of February 2005, compensation payments have totaled approximately £13 billion (or \$24 billion),¹⁰⁶ and hundreds of millions were also paid out in fines and penalties.¹⁰⁷ Further reform measures have been taken, and the system continues to be scrutinized, but such measures have done little to restore worker confidence in private accounts.¹⁰⁸

According to the government-appointed British Pensions Commission, the present level of pension right accrual, both public and private, will be insufficient to fund an adequate retirement.¹⁰⁹ Even the nation’s leading business lobby, the Confederation of British Industry, has endorsed raising taxes to raise benefit levels,¹¹⁰ and insurers have told Britons that private accounts are unlikely to match their second-tier public benefits and have advised them to move back into the public system.¹¹¹ Consequently, in 2004, 500,000 British workers opted out of the private account system and back into the state system.¹¹² This was “the biggest shift back into the state system ever.”¹¹³ In 2005, another 250,000 were expected to move back.¹¹⁴

102. *Id.* at 36.

103. *Id.*

104. Norma Cohen, *A Bloody Mess*, AM. PROSPECT, Jan. 11, 2005, available at <http://www.prospect.org/web/page.wv?Section=root&name=ViewWeb&articleId=8997>.

105. *Id.*

106. Davis & Moffett, *supra* note 77, at A1.

107. Cohen, *supra* note 104.

108. *Id.*

109. FIRST REPORT OF THE PENSIONS COMMISSION 205 (2004), available at <http://www.pensionscommission.org.uk/publications/2004/annrep/fullreport.pdf>.

110. Cohen, *supra* note 104.

111. Lopez, *supra* note 59, at E1.

112. *Id.*

113. *Id.*

114. *Id.*

C. Australia

Like Britain, Australia's provision of formal retirement income dates back to the late nineteenth century, but distinct from most other nations, funding was from general revenues, not from earmarked PAYGO contributions.¹¹⁵ In 1992, privatization was introduced in the form of a compulsory, national, employer-based contributory retirement income system managed by the private rather than the public sector.¹¹⁶ This development changed the Australian retirement system into a three-tiered one, comprised of a social assistance base (Age Pension), a national contributory system named the "Superannuation Guarantee," and a private contributory superannuation system at the top.¹¹⁷ The private, tax-advantaged retirement accounts require mandatory employer contributions of 9% of earnings up to a specified maximum earnings level.¹¹⁸ Employees also must contribute 3% of their salary up to a specified level.¹¹⁹ Failure of the employer to make the required contribution results in the employer being taxed for the amount by the government, which then makes the contribution on behalf of the employee.¹²⁰

These contributions are then invested in regulated superannuation funds.¹²¹ In general, superannuation refers to the payment of a benefit to a person upon permanent retirement.¹²² Superannuation funds are trust funds managed by private trustees.¹²³ They may be employer or industry specific, or available to any member of the public.¹²⁴ They are tax favored, but not tax exempt.¹²⁵

115. *Id.*

116. Linda S. Rosenman, *The Social Assistance Approach and Retirement Pensions in Australia*, in JOHN BREAU, JAMES MIDGLEY & MICHAEL W. SHERRADEN, AN INTERNATIONAL INQUIRY 17.

117. Hazel Bateman & John Piggott, *Australia's Mandatory Retirement Saving Policy: A View from the New Millennium*, SOCIAL PROTECTION DISCUSSION PAPER SERIES, Mar. 2001, at 6, available at [http://wbln0018.worldbank.org/HDNet/hddocs.nsf/0/0310a48d5288b8b785256a1700504806/\\$FILE/0108.pdf](http://wbln0018.worldbank.org/HDNet/hddocs.nsf/0/0310a48d5288b8b785256a1700504806/$FILE/0108.pdf).

118. *Id.* at 10.

119. *Id.* at 6.

120. Jerry W. Markham, *Privatizing Social Security*, 38 SAN DIEGO L. REV. 747, 813 (2001).

121. *Id.*

122. THE LAW REFORM COMM'N, COS. & SECS. ADVISORY COMM., COLLECTIVE INVESTMENTS: SUPERANNUATION 6 (1992), available at <http://www.austlii.edu.au/au/other/alc/publications/reports/59/59.pdf>.

123. *See id.* at 37.

124. *See id.* at 8-9.

125. *See id.* at 15.

Key to the Australian system is the Age Pension, which is a means-tested old age income security feature funded from general revenues;¹²⁶ the Age Pension provides a low rate of benefit and a low rate of income replacement.¹²⁷ In fact, the Age Pension is sometimes described as a “backstop” because while it provides a safety net against poverty for the aged, it does not yield generous benefits.¹²⁸ For example, the Age Pension provides free or heavily subsidized health care including acute treatment, long-term residential care, and prescriptions.¹²⁹

A drawback to the Australian system is its relative lack of longevity. According to an Australian Senate committee convened in 2002 to study retirement, Australian baby boomers will not have enough years to accumulate a retirement benefit sufficient to meet an adequate retirement income because the system has only been in place since 1992.¹³⁰ The committee concluded that further reform is needed to create incentives for greater voluntary contributions, as further compulsory contributions cannot be sustained in the current economic climate.¹³¹ In addition, the Australian system falters in the provision of benefits, or payout, phase because of a structure that does not ensure retirement income streams and permits lump-sum distributions.¹³² Further issues arise because the retirement age of the compulsory superannuation pillar has not been aligned with the Age Pension retirement age.¹³³ Accordingly, employees have an incentive to retire as early as age fifty-five and spend their lump-sum superannuation benefit.¹³⁴ After dissipating their superannuation benefit, the employee then becomes eligible at age sixty-five for the means-tested Age Pension.¹³⁵ Hence the superannuation and the age pensions appear to reflect conflicting values; the former encourages

126. Rosenman, *supra* note 116, at 22.

127. *Id.* at 27.

128. *Id.*

129. *Id.* at 28.

130. *Thoughts on Personal Account Proposals Related to Experiences in Other Countries*, SPENCER BENEFIT REP. (May 23, 2005), <http://www.aspenpublishers.com/frame.asp?source=feature0523>.

131. *Id.*

132. Bateman & Piggott, *supra* note 117, at 6.

133. *Id.* at 24–25.

134. Sophie M. Korczyk, *Women's Issues in Individual Social Security Accounts: Chile, Australia and the United Kingdom*, BENEFITS Q., July 1, 2005, at 41.

135. Gern, *supra* note 69, at 448.

savings, while the latter, because of the means-testing feature, discourages it.¹³⁶

D. Sweden

The Swedish Social Insurance system consists of two tiers: a flat rate basic pension funded on a PAYGO basis and an income-related supplementary pension (ATP) that was created by legislation passed in 1998.¹³⁷ Workers began contributing a mandatory 2.5% of eligible earnings to their private accounts, known as premium pensions, in 2000, a poor year for the stock market, and performance has been relatively mediocre since then.¹³⁸ The remaining 16% of payroll contributions continues to fund benefits on a PAYGO basis.¹³⁹ Individual accounts carry additional administrative fees as well, but transaction costs are minimized by utilizing omnibus trading accounts.¹⁴⁰ The private accounts system holds about \$20 billion in assets.¹⁴¹

Swedes can choose a “default” government fund, the Premium Saving Fund, and/or make their own investment selections through the Premium Pension Authority,¹⁴² up to a maximum of five from among 660 funds. Mutual fund companies spent an estimated \$94.4 million on advertising prior to the implementation of the system in an effort to influence the investment decisions of Sweden’s 4.4 million workers.¹⁴³ Very specialized and risky funds were offered: for example, a fund that invested only in western Sweden, a fund endorsed by Stefan Edberg, a retired tennis star, and “Absolut Strategies” after the vodka by the same name.¹⁴⁴ Since 2000, the return on the government fund, composed of Swedish and foreign equities,

136. Korczyk, *supra* note 134, at 42.

137. See generally Swedish Soc. Ins. Admin., About Pension, <http://www.forsakringskassan.se/sprak/eng/pension> (last visited Jan. 23, 2006).

138. See generally PREMIUM PENSION AUTH., PREMIUM PENSION AUTHORITY (2003), available at <http://www.ppm.nu/dbfiles/pdf/2164.pdf> (outlining background, mission, and organization of PPM).

139. Susan Stranahan & Carol Simons, *Sweden’s Choice*, AARP BULL., Feb. 2005, available at http://www.aarp.org/bulletin/socialsec/ss_sweden.html.

140. See R. Kent Weaver, *Design and Implementation Issues in Swedish Individual Pension Accounts*, SOC. SEC. BULL., May 2005, at 38, 40–41, available at <http://www.ssa.gov/policy/docs/ssb/v65n4/v65n4.pdf>.

141. PREMIUM PENSION AUTH., *supra* note 138, at 10.

142. *Id.* at 2.

143. Davis & Moffett, *supra* note 77, at A1.

144. *Id.*

has been negative 29.9%.¹⁴⁵ On average, investors who actively chose funds saw returns of negative 39.6%.¹⁴⁶

Most participants, confused by the dizzying array of choices and disappointed by poor performance, have lost interest in actively choosing a fund. For example, in 2004, the government assigned more than 90% of new labor market entrants to the government-sponsored default fund because they failed to make an active choice of funds.¹⁴⁷ According to Annika Sundén, an economist at the Center for Retirement Research at Boston College, “[t]he experience taught people that the best thing to do is not do anything, even though this goes against the whole idea of choice in the first place.”¹⁴⁸

The Swedish system offers a number of lessons about implementing a mandatory private account pillar. Centralized administration keeps administrative costs down, but considerable lead time is required for investment implementation. An overly large number of fund options are likely to be offered unless the government imposes limits or imposes strong entry barriers. Engaging new workers in the fund choice process is likely to be difficult, and a significant percentage of those who do make a choice may choose highly specialized and risky funds.¹⁴⁹

IV. Conclusion

What lessons can be learned from the relative successes and failures of Chile, Great Britain, Australia, and Sweden, and how would their experiences translate to the United States in its efforts to privatize Social Security? Presuming that the goal of Social Security is to assure basic pension coverage to retirees, the disabled, and survivors, is a defined contribution plan with private accounts a better alternative than the current defined benefit plan, or can less drastic modifications to the current defined benefit program be made in order to better serve this fundamental goal?

The two most cited experiments in Social Security privatization, Chile and the United Kingdom, have both had similar outcomes:

145. ANNIKA SUNDÉN, CTR. FOR RETIREMENT RESEARCH AT BOSTON COLL., HOW DO INSIDER ACCOUNTS WORK IN THE SWEDISH PENSION SYSTEM 4 n.16 (2004).

146. Lopez, *supra* note 59, at E1.

147. Weaver, *supra* note 140, at 38.

148. Stranahan & Simons, *supra* note 139.

149. Weaver, *supra* note 140, at 38.

politicians portrayed privatization as an enhancement for seniors; however, in reality many of those with private accounts have been forced back to work or left in poverty because of insufficient yields on their accounts. In both countries, the state systems provided better benefits.¹⁵⁰ According to Dagoberto Saez, a sixty-six-year-old Chilean laboratory technician who opted out of the traditional Social Security system and who had planned to retire in March 2005, “I have a salary that allows me to live with dignity, and all of a sudden I am going to be plunged into poverty, all because I made the mistake of believing the promises they made to us back in 1981.”¹⁵¹ His pension fund has reported to him that his nearly twenty-four years of contributions will purchase a twenty-year annuity paying about a third of his monthly salary (\$315), while his colleagues at the same employer and pay grade who stayed with the old system will enjoy a lifetime benefit more than double that size (\$700).¹⁵²

The most similar model to the U.S. proposal is the voluntarist U.K. system where scandal and fraud have caused huge national expenses and have made it extremely difficult to regain worker confidence. Robin Ellison, Chairman of the National Association of Pension Funds, recently stated, “It is curious that as we’re moving towards one system, the United States appears to be thinking and moving to the system we are moving away from.”¹⁵³

Events in Australia, Chile, and the United Kingdom all demonstrate the insufficiency of privatization to keep citizens from poverty. Sweden’s experience shows how citizens, when presented with too many choices and poor performance, lose interest in managing their own accounts, are difficult to re-engage, and prefer to opt back into the defined benefit system. High costs in both the United Kingdom and Chile¹⁵⁴ attributable to sales and other provider-levied fees reduced returns. Note that costs on British private

150. Peter Siavelis, *Weapons of Social Destruction Don't Exist*, WINSTON-SALEM J., Mar. 7, 2005, at 11.

151. Rohter, *supra* note 55, at 1.

152. *Id.*

153. *Morning Edition Comparison of Bush's Retirement Proposal to the Pension System in Britain* (NPR radio broadcast, Feb. 17, 2005 (transcript on file with the Elder Law Journal)); Nat'l Ass'n of Pension Funds, <http://www.napf.co.uk/aboutus/structure.cfm> (last visited Jan. 23, 2006).

154. HENRY J. AARON & JOHN B. SHOVEN, SHOULD THE UNITED STATES PRIVATIZE SOCIAL SECURITY? 109–10 nn.4 & 5 (Benjamin M. Friedman ed., 1999); *see supra* text accompanying note 69.

accounts are estimated to consume an average of 43% of an individual's account value during a typical forty-year career; contrast that with less than 1% of benefits for current U.S. Social Security administrative costs.¹⁵⁵

Australia has also experienced high costs because of the significant overhead expenditures related to administering such small accounts. The Swedish system is centralized, keeping costs relatively low, but requiring a good deal of lead time to execute participant investment transactions.

The better alternative to privatization would be to adopt a moderate, prudent approach, emphasizing a fix of the current system and encouraging additional savings outside of retirement. For example, modest tax increases and tempered benefit cuts, phased in over decades would better meet the objective of protecting retirement, disability, and family post-death security. Social Security was never designed to be the sole source of income for retirement, but rather to be part of a "three legged stool" of Social Security, pensions, and savings.¹⁵⁶ American workers should be saving for their retirement on a personal basis and through employer-sponsored or other retirement accounts, such as 401(k)s, 403(b)s, and IRAs. These programs should be enhanced to encourage citizens to increase contributions.

Removing the cap on the earnings tax beyond the current \$90,000 limit would also strengthen the program. The Medicare tax has no cap and the Social Security tax should receive parallel treatment if future protection is to be achieved. Federal Reserve Governor Gramlich in a recent lecture stated:

My idea on the tax side is relatively straightforward. Today, Medicare Part A is financed by a 2.9% combined payroll tax on all wages, and Social Security is financed by a combined 12.4% combined payroll tax on wages up to \$90,000, a threshold that is increased each year with the growth in wages. One of my goals is to standardize treatment across the programs, and I would do that by removing the \$90,000 cap on wages and salaries that are taxable for Social Security purposes. Let's treat both programs alike by taxing all wages for both programs. Will this represent a tax

155. THE CENTURY FOUND., *BROKEN ENGLISH: THE UNITED KINGDOM'S TROUBLED EXPERIMENT WITH PERSONAL PENSIONS* 3 (1999), available at http://www.socsec.org/facts/Issue_Briefs/PDF_versions/5issbrf.pdf (last visited Jan. 23, 2006).

156. Soc. Sec. Admin., *Frequently Asked Questions About Social Security's Future: "Should I Count on Social Security for All My Retirement Income?"*, <http://www.ssa.gov/qa.htm> (last visited Jan. 23, 2006).

increase for Social Security? Of course it will, though in part the removal of the cap merely adjusts for the fact that because of the widening of the income distribution, substantially more wages are above the cap than in earlier times. But the main reason for removing the taxable payroll cap is that both programs together are woefully under-funded, and this would be a small step in the direction of fiscal responsibility.¹⁵⁷

Indeed, eliminating the cap would erase much of the projected Social Security shortfall over the next seventy-five years.¹⁵⁸

Raising the cap is not a “soak-the-rich” strategy, but rather a proposal to apply the Social Security tax equally to all Americans. For example, a worker who currently earns \$50,000 annually pays \$3,100 a year in Social Security tax (6.2%); someone who makes \$90,000 pays \$5,580, again 6.2% of salary.¹⁵⁹ But because of the income cap, the percentage of total income paid to Social Security becomes increasingly smaller once that \$90,000 mark is passed. To further illustrate, a worker whose annual salary is \$200,000 still pays only \$5,580, or about 2.8% of income to Social Security. A person making \$1,000,000 annually also pays only \$5,580 or just 0.56% of their income.¹⁶⁰ And for the average CEO of a major company who, in 2004 earned \$9.84 million,¹⁶¹ his or her contribution to Social Security is just 0.06% of income. These calculations beg the question: is the goal of Social Security to protect the wealthy or to provide a safety net?

An additional innovative enhancement would be to establish a system where a worker could automatically deposit their tax refund into an IRA or qualified plan each year, and the government would provide a match. One such experiment was recently conducted by H&R Block in conjunction with the Pew Charitable Trust. It found that workers’ rate of voluntary IRA contributions increased significantly for workers receiving a match.¹⁶² Overall, for those to whom this automatic deposit of a refund option was made available,

157. Governor Edward M. Gramlich, *A First Step in Dealing with Growing Retirement Costs*, Spring 2005 Banking and Finance Lecture at Widener University (Apr. 21, 2005), <http://www.federalreserve.gov/boarddocs/speeches/2005/20050421/default.htm>.

158. Lawrence Mishel, *Lifting Cap on Social Security Taxes Would Rescue Retirement Program*, J. STAR, May 15, 2005, http://www.epi.org/content.cfm/webfeatures_viewpoints_lifting_cap_on_SS_taxes.

159. Peter Blackstock, Letter to the Editor, USA TODAY, June 6, 2005, at 12A.

160. *Id.*

161. Claudia H. Deutsch, *Executive Pay; My Big Fat C.E.O. Paycheck*, N.Y. TIMES, Apr. 3, 2005, § 3.

162. Editorial, *H&R Blockbuster*, N.Y. TIMES, May 17, 2005 at 20.

“the ease of contributing greatly influenced [their] decision to save.”¹⁶³ Provision of such a deposit option, and especially the matching contribution, would be a far less expensive alternative than the partial privatizing of Social Security as proposed by the administration, and would increase the rate of retirement savings among lower and middle income workers.¹⁶⁴

National trends indicate that employers are moving away from sponsoring defined benefit plans in favor of defined contribution plans,¹⁶⁵ in an effort to shift the investment risk of retirement onto the individual.¹⁶⁶ Social Security provides a counterbalance to the additional individual risk that workers are taking on in light of this trend. Employees should be encouraged to increase savings in other tax-sheltered retirement vehicles such as 401(k) plans and IRAs, as well as other savings programs. Social Security, with its conservative investments and assured, though small, benefit structure, should be preserved to provide diversification for workers’ retirement planning.

John Mueller, former economic counsel to the House Republican caucus, originally favored privatization, but changed his opinion after studying the issue. Speaking to the National Press Club in 1997, Mueller said that arguments in favor of ending the PAYGO system are “a curious mix of horse-and-buggy economic theories with a remarkable ignorance of financial markets,”¹⁶⁷ and that the PAYGO system is “one of those genuine cases, like national defense, in which the government is necessary to perform a role that the private market alone cannot—in this case, providing the ‘foundation layer’ of retirement income.”¹⁶⁸ Mueller also noted that “since 1900, the [twenty] year average annual return on the stock market was negative about one-third of the time—from 1901 to 1921, 1928 to 1948 and 1962 to 1982,”¹⁶⁹ an ominous historical note for any potential equity investor dependent on the market for retirement income.

Whether privatization comes to pass or not, its proposal will at least have served one valuable purpose, and that is to further a

163. *Id.*

164. *Id.*

165. JOHN H. LANGBEIN & BRUCE A. WOLK, PENSION AND EMPLOYEE BENEFIT LAW 55–56 (2000) (quoting Shifting Pension Coverage, 5 U. CHI. PUB. POL’Y & AGING REP. 1, 3 (1992)).

166. *Id.* at 60.

167. Lopez, *supra* note 59, at E1.

168. *Id.*

169. *Id.*

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national dialogue about retirement security and encourage a widespread examination of the purposes of Social Security and possibilities for alternatives. When the ideological din abates, Congress should enact prudent legislation for modest tax increases, tempered benefit cuts phased in over decades, and enhanced incentives for greater contributions to private retirement plans (such as IRAs and 401(k) plans). The experiences of the United Kingdom, Chile, Sweden, and Australia offer compelling arguments for carefully considered action to strengthen the program without destroying it.