

CRITERIA FOR REFORMING SOCIAL SECURITY

David Ranson

There are two views on Social Security reform, both of them ardently held and widespread. One is that the system is not in any fundamental difficulty and needs only piecemeal modification. The other, to which I adhere, is that Social Security is in very bad shape and needs fundamental change. The approach I suggest, an "axiomatic approach," does not assume anything to begin with. It consists of a search for goals, a consideration of goals, and an examination of their consequences. It can lead to surprisingly specific conclusions.

I start with the presumption that all is not well with the Social Security system in spite of the most recent shoring-up that resulted from the work of the Greenspan Commission. Indeed, as Peter J. Ferrara ably demonstrates in a paper just published by my firm,¹ the arrival of one more recession would immediately reopen the wounds. To change the system sufficiently to immunize it from economic change will require much more fundamental reform than policy makers have yet been willing to contemplate.

Popularity and Growth of the Program

Two points need to be considered before developing an axiomatic approach to Social Security reform. First, Social Security is admittedly a very popular program. But that is the case with any Ponzi scheme (and I have always believed that analogy is correct). Ponzi schemes are indeed popular among the early participants, and it is only in the later stages that people get upset. Even when it is backed

Cato Journal, vol. 3, no. 2 (Fall 1983). Copyright © Cato Institute. All rights reserved.
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¹Peter J. Ferrara, "Social Security: The Crisis Draws Closer," *The Political Economy in Perspective*, H. C. Wainwright & Co. Economics, May 9, 1983.

by government compulsion, I believe that any such pyramid will eventually collapse.

Second, why has the Social Security system grown so much over the decades? My theory is that it is due, in part, to sheer bureaucratic inertia. For example, the superindexing that went into the benefit formula in 1972 is conceded by everyone to have been a technical mistake. Yet it took five years to get it corrected—even in a climate where increasing concern was being expressed about the long-range solvency of the system. During that period, some 5 to 10 percentage points were added to total Social Security expenditures, and we still have that extra spending with us today. The incentives within government are such that no serious attempt was made to reverse the rise in spending.

The Need for Axioms

Debates on Social Security (especially those within a political body like the Greenspan Commission) sound like fights among people who are starting from predetermined positions. The participants are not sharing ideas and modifying their views as they learn more. Moreover, the parameters of discussion take full account of the inertia to which I just referred. The debate takes as a given the system as it exists now and assumes that whatever change is suggested will have to be modest.

In a situation like this (if there is agreement at all), consensus amounts only to a compromise reached through a bargaining process. It is not a consensus in the true sense of the word. Moreover, given the way the activism, the political influence, and the media exposure of the different factions change from year to year, 10 years can go by and the bargain that was reached originally may no longer represent the new power balance at all. So the system lurches from one bargain to another, while no one addresses the deeper problems.

The patch-up job that has been achieved during the past year entailed an adversary process at the end of which all participants seem to be unhappy with the result. How much more divisive, then, is real reform going to be? It seems inconceivable to me that general agreement can be reached on any large issue as long as each constituency argues from inside its own straitjacket of political calculation, relying on coalitions of disparate views to vote down proposals it sees as dangerous to its position. If general agreement can be reached at all, it will have to be based on more than a debate among political groups. In a sense, reform may be premature now, however high the costs of delay, because the constituencies are not yet frightened

enough to let go. When they do, a common analytical approach will be urgently needed.

Calculations about what is politically "feasible" have their place. In a democracy, they help to guarantee that the views of the electorate as a whole, where leadership ultimately lies, will not be overridden. But I feel there are many circumstances in which the electorate looks to politicians for a kind of specialized leadership. It is easy to lose one's way in the maze of complexity within which the debate over the system is carried on. The leadership needed from elected representatives, *then*, involves much more than the ability to identify a compromise between opposing factions. It requires a sense of direction based on a reasoned analysis of where and how trouble has arisen in the past.

An approach to problem solving that might make a lot more sense would start from a common basis for agreement rather than from a set of fixed positions that necessarily spell disagreement from the beginning of the negotiations. The approach I suggest could bring the electorate itself into the decision-making process. I think it is possible for us to agree on many points, especially in terms of broad principle. The broader the principles, the more universal the agreement. I will call these principles "axioms," because that term is often used in other fields in the same way that I propose to use it here.

I do not want to add to the confusion by contributing a particular blueprint for reforming Social Security. A set of axioms by itself does not imply one, and there are already plenty of proposals around. But if we have axioms, we can evaluate other people's blueprints and other people's piecemeal modifications if necessary. We get an objective view of whether those plans take us closer to the axioms, the ideals, or further away.

At worst, this approach can stimulate those who are uncomfortable with the axioms I suggest to come up with and defend their own. At best, it can distinguish reform proposals that address deeper problems from those that conceal them or merely patch them up. This approach can draw more people into the thought process, including many who are now deterred by the complexity of the calculations or by the heat of the debate. Working on axioms can also enable progress to be made and conclusions to be drawn in surprisingly specific ways.

Some Suggested Axioms

There are a couple of caveats. The axioms I suggest here are not the only ones that make sense. My purpose will have been met if others choose to add to them. Nor are the consequences listed here

the only consequences. I can only claim to have begun the process. Nor are all desirable axioms necessarily compatible with one another. However, I think that the axioms I outline are compatible. They should also elicit almost universal agreement from the electorate if that they are clearly explained. Finally, I recommend that we consider axioms without trying to determine the feasibility of applying them. At this stage, that not only would be distracting but also would conflict with the main objective, which is to sketch out areas of common agreement.

The four axioms I propose are as follows.

1. *Economic efficiency.* Efficiency is a technical term dear to economists; a less hallowed term to explain what I mean is *nondistortion*. In recent years, many economists have studied the troubles of the Social Security system. Although their political viewpoints differ, they have brought with them awareness of an issue that was often neglected earlier: A large government program can have powerful effects on business and personal economic decisions, and thereby on the health of the economy. It seems a worthwhile goal, therefore, to move toward a situation in which unnecessary distortions are eliminated, and in which all distortions are minimized.

There are many ways in which government programs can distort the economy. However, I am mainly concerned with the overall drag on economic activity that follows from imposing disincentives on firms to use labor, on workers to earn larger incomes, and on entrepreneurs to start businesses.

In a society where taxation is already severe, it is all the more undesirable to add to the disincentives that already discourage "aboveground" economic activity. A redesigned Social Security system ought to restore, rather than further weaken, incentives to participate in the economy. A system that is redistributive cannot be efficient in this sense. Taxing Peter to pay Paul discourages both from working and eventually undermines the system by weakening its tax base.

There are two ways to discourage production and work effort. One is to charge a fee of so many cents for every dollar that is earned by the worker or paid by the employer. It does not matter for my purpose whether the worker or the employer pays this tax. In either case it is a fee that must be paid to allow the labor market to operate. And when you tax something you do get less of it.

The other way is to enable people to live without working. In its extreme form, such a policy would give a free pension to each person regardless of how much work he did. That does not bestir

people to work harder; indeed, it removes one of the most basic drives, the incentive to work in order to survive. Social Security has an element of this disincentive in it, too. A person becomes fully insured after his first 10 years of employment. By the time he is old enough to plan for retirement, the length of his employment has little to do with the size of the pension he receives.

2. *Recognition of sunk costs.* One of our greatest political problems is the fate of the many individuals who already receive (and many of whom depend on) Social Security benefits. A powerful constituency opposes benefit cuts outright because it fears establishing a precedent for much larger cuts. On the other hand, it is sometimes argued that reforming the system would necessitate reducing future benefits.

This is untrue. Perhaps continuing the system as presently designed would require benefits to be cut. But the design of a new system has nothing to do with the liabilities that (rightly or wrongly) have been accrued in the past. Even though they have yet to be paid, these claims on the present system are a sunk cost. They have now taken their place in the distribution of wealth. Whether to interfere with this distribution of wealth by repudiating some of these liabilities or to finance them somehow is a political decision. Only if we insist on saddling a redesigned system with the liabilities of the past does this apparent dilemma arise.

In a way, this axiom is an application of the old proverb that two wrongs don't make a right. Sunk costs should not be allowed to influence future decisions.

3. *Depoliticization.* Anxiety about the future, particularly among recipients of benefits, can be traced in part to a feeling of being vulnerable to short-term political forces. Correspondingly, critics of the present system often attribute its overcommitments to pork-barrel politics. Congress frequently amends the Social Security Act in minor ways, and occasionally in major ones. The system ought never to be a political football. Indeed, once established, a properly designed system would be immune to the pressures of politics.

4. *Openness.* A further barrier to reform is that the system is too complicated for the man in the street to come to grips with the problems he hears so much about. A well-designed system would be simple and easily understood by its participants. The complexity of the existing benefit formulas and the sensitivity of the system to future trends in inflation, fertility, and so on, have led to confusion, uncertainty, and cynicism. Younger people doubt they will

ever see the benefits to which their contributions are theoretically laying claim. Rumors of large unfunded liabilities, although officially disputed, do not die away.

There is no way for the average person to find out the size of the Social Security pension he has earned. He also may be unaware, for example, that the unfunded liabilities now amount (perhaps conservatively) to about \$30,000 for each man, woman, and child in the population. This amount of implicit debt dwarfs anything that has ever occurred. Imagine instead a system in which it was exactly known not only how much debt had been accumulated, if any, but also how much of a pension one could expect upon retirement, as well as where the means to pay that pension would come from. Such a system would be more appealing to the average citizen than our current Social Security system.

Financial Soundness and Other Criteria

Conspicuously missing from the above axioms is the requirement that Social Security be self-financing and immune from financial threat. I omit it because it is already implicit. It is hard to imagine how a system constructed to follow these axioms exactly could get into trouble.

The benefit formula would be simple, universally understood, easily calculable, and would provide no route for subsidizing one group at another's expense. Any number of participants could be permitted to opt out without endangering the financial status of the remaining participants. No new unfunded liabilities would accumulate. It would be very difficult, perhaps even impossible, to incur a cash deficit. And such a system would help restore prosperity, because it would impose little or no disincentive to work, produce, save, or start a new business. The likelihood of a crisis would be close to zero. No one would fear losing his benefits, and no one would feel that he was being cheated. The predicament of the present system could not arise.

However restrictive they may be in some dimensions, the axioms I suggest leave open many questions on which reasonable people may differ. The size of a redesigned system in relation to the economy, the types of risk that are covered, the extent to which participation is compulsory, and the extent to which the federal government delegates its own role as insurer are all open issues. Although my own preference is for a private system with maximum freedom of choice, I do not think economists have the prerogative to pronounce on such questions. If agreement could be achieved on the axioms,

they should be submitted to the electorate. Finally, the axioms should be regarded as ideals to be approached, rather than achieved (although I prefer following them faithfully).

Some Consequences of the Axioms

The four axioms and some of their consequences are outlined in table 1 (at the end of this article). First is the *efficiency* axiom. Suppose we were to design a system that did not subsidize one group at the expense of another and that did not provide disincentives to economic activity. And suppose that we pushed these requirements to the logical extreme. The result would be a program that created a one-to-one link between each dollar contributed and the actuarial benefit (in terms of discounted value) earned by that dollar. That, of course, is a very far-reaching conclusion, one that already would close off many reform proposals. However, I find it an appealing idea that would attract the electorate. The same idea appears in the IRA-type proposals that are being discussed by Ferrara and others.

The efficiency axiom has various other consequences. We would not want a Social Security tax as such at all, although we would still somehow have to pay off the liabilities that have accumulated. We would eliminate any means tests or retirement tests that imposed marginal tax rates on particular groups. Following this axiom would also move the Social Security system closer to market solutions such as privatization. The element of coercion could be reduced. But the axiom does not presume a privatized system. That question belongs to a separate axiom.

Another consequence of having efficiency as a goal is that the government would follow the same set of actuarial formulas that a private insurance system would follow if it were unregulated. Differences in life expectancy, according to an objective criterion, should be reflected in the benefit formulas; any other method is a distortion.

The axiom of *sunk cost* means simply that we should acknowledge the liabilities that have accumulated up to now as a debt of the present, regardless of when they are to be paid off in the future. The accrued cash outflow should be regarded as something we have to deal with. But it is illogical to assume (as many do) that any system we build in the future must be saddled with this burden—perhaps in addition to the burden of being self-financing. One even hears the double fallacy that no future system can be self-financing, because it is too expensive to pay for both burdens.²

²Harry Ballantyne, chief actuary of the Social Security Administration, letter to the editor, *Wall Street Journal*, May 11, 1983, p. 35.

The *depoliticization* axiom simply means immunizing the system from short-term political change. It means guaranteeing whatever benefit formula is adopted by issuing bonds as the future benefits are earned. Moreover, those bonds should bear the full faith and credit of the government. They should not be repudiable. The system should also be institutionally isolated to strictly limit the political power of anyone to alter those benefit formulas or to repudiate the debt.

The fourth axiom, *openness*, requires that the system be completely understood by the electorate. Nothing should be hidden. That includes not hiding the accumulated liability, however large it may be and however much damage acknowledging it will do to the reported government deficit. The budgetary practices of the federal government do not recognize the accrual of these liabilities, but they should.

Openness also implies separating all the noninsurance elements from the present system by transferring them to some other program. It can only confuse understanding to keep the insurance and redistributive functions of the program together. Participants should be informed of where they stand in the system. In this situation one axiom assists another, because it is much easier to calculate the standing of an individual when the benefit formula consists of a one-to-one link between sacrifice and reward. A participant could receive a notice once each year, or however often we choose, stating exactly how much he has contributed, exactly how much his pension would be if he were to retire at a given age, and what the pension would be worth if he became disabled today. No one is able to make this calculation under the complex system of today.

Finally, openness implies eliminating arbitrary cutoff points that discriminate capriciously among different people and make it more difficult for each person to plan his affairs. As Paul Craig Roberts has pointed out, the 100,000-percent marginal tax rate that the Greenspan Commission thoughtlessly would have imposed on single (unmarried) Social Security recipients as their outside income reached \$20,000 would have introduced much arbitrariness and unpredictability into their financial affairs.³ There are many arbitrary cutoff points in today's benefit formula that are not consistent with the viewpoint that people should know exactly where they stand.

The axiomatic approach is detailed in table 2 and the following tables (at the end of the article). Table 2 suggests some shorthand terms used in discussing some of the design options in later tables.

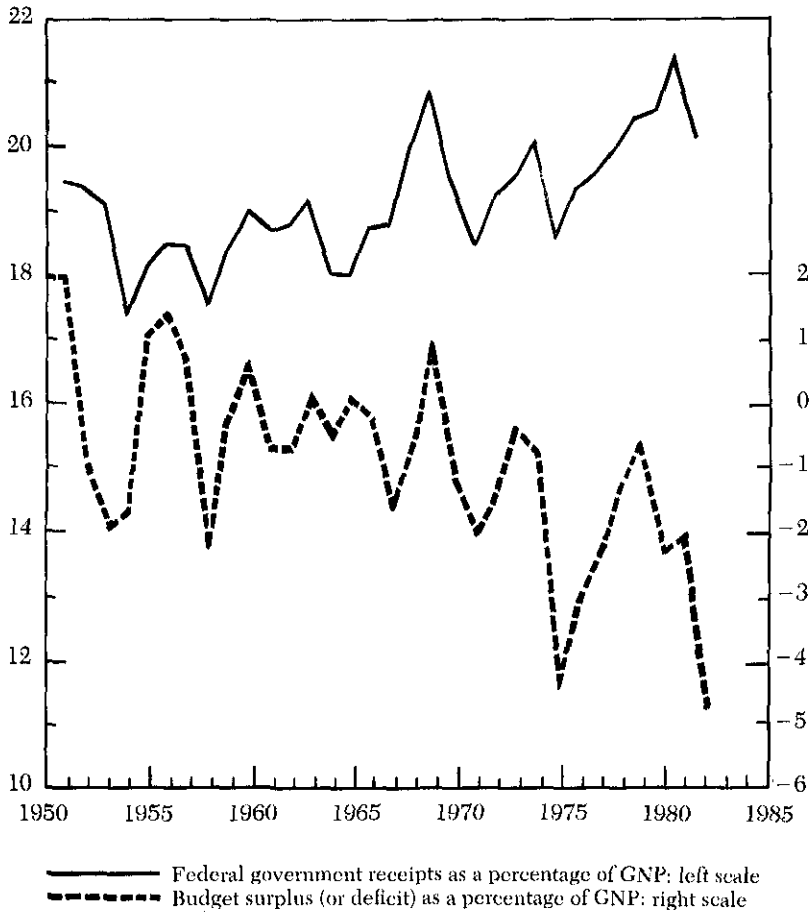
³Paul Craig Roberts, "Social Security: Myths and Realities," *Cato Journal* 3 (Fall 1983): 399.

Table 3 applies some of this language to outline the shape of a Social Security system redesigned according to the suggested axioms. Within the scope of this overall design, tables 4 through 6 lay out various options.

Rescuing the System by Tax Increases

Some analysts insist that the answer to a deficit is a tax increase. The following chart casts light on this point. It focuses on the total federal deficit, but the same principle applies to Social Security;

FEDERAL RECEIPTS AND THE BUDGET



Prepared by H. C. Wainwright & Co. Economics

I hope the implication of my point will be clear. The changes in the budget deficit (the broken line) and in total revenue (the solid line) are compared over the past 30 years. Each amount is measured as a percentage of Gross National Product. Notice the positive correlation; short-term ups and downs in federal revenue correspond to short-term ups and downs in the deficit. No one denies that correlation, and it is easy to explain in terms of the business cycle.

But what is the long-range relationship between federal revenues and federal deficits? Tax rates have been going up, yet the deficit has been growing. This evidence tells us far more than any theory about the power of tax increases to bring deficits toward balance. Tax increases generally do not work as a means of balancing the federal budget. There is no way to prove that the deficit would not have been even greater if tax rates had been held down. However, history shows that tax increases and widening deficits go together. This is the reverse of what some analysts claim. Further efforts to solve the Social Security crisis by imposing higher and higher tax rates, far from narrowing the deficit, may accompany a deficit that continues to widen indefinitely.

TABLES 1-6

TABLE 1	
AXIOMS OF REDESIGN: SOME CONSEQUENCES	
Axioms	Consequences
<p>1. <i>Economic efficiency</i> The redesigned program should be actuarially sound, and should impose a one-to-one link from future contributions to actuarial value of benefits earned.</p>	<p>Social Security tax as such will be abolished. The retirement test will be eliminated. The system will move closer to market solutions such as privatization. Future contributions will not be tax deductible; benefits thereby earned will not be taxed. Contributions will earn interest that is tax free. Government will follow accepted private-sector formulas for assessing differences in life expectancy according to age, sex, health, and other objective criteria.</p>
<p>2. <i>Sunk cost</i> The program would not try to reverse past redistributions of income.</p>	<p>The liabilities and cash flow accrued from the old system will be acknowledged. No balance will be imposed between cash outflow and cash inflow from new contributions. Repayment to contributors of their past Social Security taxes will not be compelled.</p>

Continued on next page

TABLE 1 (cont.)

Axioms	Consequences
<p>3. <i>Depoliticization</i> The new system should be immune from short-term political changes.</p>	<p>The new benefit formula will be guaranteed by issuing bonds as future benefits are earned.</p> <p>The system will be isolated so as to severely limit the power of political considerations to alter the benefit formula or to cause default on the benefits.</p> <p>Market prices will be used for all valuation problems: e.g., interest rate paid on contributions; equivalence between annuities and amounts of principal.</p>
<p>4. <i>Openness</i> The new system should be utterly simple and understood by the electorate, and nothing should be hidden.</p>	<p>All noninsurance elements will be transferred to other government programs.</p> <p>Participants will be kept informed of the status of their financial stake and the condition of the system as a whole.</p> <p>Liabilities such as future pension claims will not be hidden by not being acknowledged in the unified budget.</p> <p>Arbitrary cutoff points that discriminate capriciously among similar individuals will be avoided.</p>

TABLE 2
TERMINOLOGY

<i>Retirement Test</i>	A provision of the present Social Security system under which 50 cents of benefit is withheld for each dollar above an exempt amount that a retiree younger than 72 has earned in the labor force.
<i>Retirement insurance</i>	A new retirement scheme that replaces the old Social Security tax and benefits earned thereby with a formula that ties future contributions to benefits on a one-to-one actuarial basis. This scheme may or may not be compulsory. It may be applied to all nonretired adults older than 21 regardless of work status. If the scheme is to be compulsory, people will be allowed to claim exemption, e.g., on grounds of disability or low life expectancy.
<i>Retirement bonds</i>	Nontransferable securities issued, for example, to make explicit or recognize the accrued claims of present workers, to recognize contributions under the new retirement insurance system, and to recognize tax-free interest earned on initial amounts with the passage of time. Guarantee status is the same as that of the recognized indebtedness of the U.S. Treasury. Government is responsible for issuing an annual statement of account to each participant.
<i>Fully insured status</i>	The ability of an individual to prove that his total vested claims from public or private plans are sufficient, given his age at that time, for him to purchase the minimum indexed annuity when he retires.
<i>Retirement annuity</i>	A tax-free indexed annuity issued to a contributor upon his reaching retirement age, in an amount actuarially equivalent to his accumulated retirement bonds.

TABLE 3
ELEMENTS OF REDESIGN

Individuals already receiving benefits	<p>Payments would continue, with modifications to cost-of-living adjustments (COLA).</p> <p>The retirement test would be abolished. Benefits would not be reduced if an individual chose to work after reaching retirement age.</p> <p>No future contributions to the system would be required.</p>
Claims of individuals not yet retired	<p>A lump-sum claim amount based on past contributions or claims earned thereby would be imputed.</p> <p>Guaranteed retirement bonds in these amounts would be issued.</p>
New arrangements for retirement insurance	<p>Social Security tax would be replaced with a scheme of contributory retirement insurance.</p> <p>Contributions would be made non-tax-deductible.</p> <p>A minimum amount would be established for vested retirement benefits accrued in private or public sources, to confer fully insured status upon individuals.</p>
Financial actions and future role of U.S. government	<p>The trust fund would be abolished.</p> <p>Retirement bonds would be issued to reflect interest accrued on previous holdings.</p> <p>Bonds would be automatically converted to a nontaxable retirement annuity, commencing payment when individual reaches retirement age.</p>

TABLE 4
DESIGN OPTIONS

FOR INDIVIDUALS ALREADY RECEIVING BENEFITS

Tax status

Benefits may be

1. tax-free,
2. subject to income tax with 50 percent exemption, or
3. subject to income tax without any exemption.

Cost-of-living adjustment

COLA may be

1. left unchanged;
2. made less generous, e.g., by switching to a consumer price index appropriate for the consumption mix of retired people;
or
3. withheld until benefit cut of a predetermined percentage has been achieved.

Guarantee status

If benefits are tax-free, retirement bonds equivalent to the actuarial value of the benefit stream could be issued.

FOR INDIVIDUALS NOT YET RETIRED

Computation of claim*

An individual's claim under the new system, and his starting point for accumulating additional pension rights, may equal

1. his claim under the old system;
2. the accumulated amount of his past Social Security taxes, plus interest;
3. his choice of (1) or (2);
4. his claim under the old system less his obligation (or zero, if the latter exceeds the former);
5. his choice of (1) or (2) less his obligation (or zero); or
6. any of the above reduced by a predetermined percentage.

Once his claim under the new system is determined, an individual will receive that amount in retirement bonds.

Privatization

An individual may be

1. required to leave his claim in the custody of the government until he retires, or
2. permitted to withdraw his claim if he invests enough of it in an approved private pension plan to reach fully insured status.

*According to his age and paid Social Security taxes, each worker has at any given time a quantifiable claim on future benefits. The amount depends partly on how the principle insurance amount is indexed to the path of average wages. It is also possible to estimate his obligation, consisting of the discounted present value of the future Social Security taxes he should pay through retirement age, on the basis of extrapolation of his average income.

TABLE 5

NEW ARRANGEMENTS FOR RETIREMENT INSURANCE

Compulsion

Contributions under the new system may be

1. compulsory for adults over the age of 21 (until they reach fully insured status);
2. compulsory, subject to exemption on grounds of disability, low life expectancy, nonresidence in the United States, and other allowable factors;
3. compulsory only for wage earners; or
4. voluntary.

Management

Contributions

1. must be paid to the federal government in exchange for retirement bonds;
2. may be paid into an approved private pension plan; or
3. must be paid into an approved private pension plan.

Recoverability

Assuming that the system is compulsory, workers

1. may not recover any of their contributions before they reach retirement age;
 2. may recover any amount over contributed (i.e., beyond what is necessary for fully insured status); or
 3. may borrow back their contributions up to the accrued amount if they can prove need and make arrangements to repay.
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TABLE 6
METHODS OF MEETING THE PREVIOUSLY ACCRUED
LIABILITIES

1. **Borrowing.** This method would increase the deficit of the unified budget from \$150 to \$350 billion per annum.
 2. **Temporarily increasing taxation.** This option would become much more appealing when the Social Security tax is replaced by a less burdensome contributory scheme of retirement insurance.
 3. **Selling government assets.** The enormous holdings of unused federal land, particularly in the western states, could be sold.
 4. **Reducing spending on other programs.**
 5. **Repudiating other liabilities.**
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Note: Even after scaling down the liabilities inherited under the old system, a cash outflow of \$200 billion per annum will have to be met without the help of the Social Security tax. This liability, although it may be considerably smaller than the unfunded liability of the old system, must ultimately be paid out of the national output. General revenues will not be available to pay the debt, because they are already committed. The residual liability must be financed by one of the five methods in this table.

“CRITERIA FOR REFORMING SOCIAL SECURITY”: A COMMENT

A. Haeworth Robertson

Introduction

Although President Reagan has signed a bill that is frequently reported to have laid the Social Security issue to rest, there are still three very important problems with the present system. These can be outlined as follows.

First, the system has financial problems that are relatively small for the next 10 years or so, but that will become enormous after the turn of the century. To restore the balance in income and expenditure solely by tax increases would require that the current employee tax rate of 6.7 percent increase relentlessly for the next 50 years to a level of 14 to 20 percent, matched by the employer.

Second, public confidence in the system has eroded seriously during the past eight years. The elderly fear substantial benefit cuts. The young fear a collapse of the entire system. To regain public confidence, the system must be soundly financed, and it must be perceived as being soundly financed.

Third, the system is out of tune with the times. In the past, the social and economic environment has changed more rapidly than Social Security, and this gap will continue to widen in the future unless significant change is made. The system must be perceived as fair and appropriate if the taxpayers are to continue supporting it. This issue is separate from whether the system is financially sound.

Accordingly, I believe that fundamental change in Social Security is both desirable and inevitable. The longer it is delayed, the more likely it is to be a hastily concocted reaction to a frenetic public outcry for reform instead of a soundly conceived and executed reform that serves the long-range interests of the nation and its citizens as a whole.

Cato Journal, vol. 3, no. 2 (Fall 1983). Copyright © Cato Institute. All rights reserved.

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How do we bring about a rationally conceived, fundamental change in Social Security? What should the new Social Security look like? We first must acknowledge that there is no single "correct" solution to Social Security's problems. The "proper design" for Social Security depends upon one's individual values and beliefs about social ethics and is therefore not something on which unanimous agreement should be expected among the various interest groups in a nation as large and diverse as the United States.

Setting forth criteria for reforming Social Security is a very critical step in rationalizing Social Security. It is second in importance only to recognizing that there is indeed a need to revise Social Security. I will suggest a few criteria that I believe are important and I will then comment upon the extent to which Ranson has considered them in his presentation.

Criteria for Reform

Cultural Compatibility

The most important criterion for a Social Security system is that it follow a philosophy, or a set of principles, that is consistent with the social and economic environment that we wish to see prevail. A social insurance system is not only a reflection of the social and economic environment that exists when the system is created, it is an important determinant of the environment that will exist in the years ahead.

Many people believe it will be best in the long run if we place increased emphasis on individual thrift and self-reliance and decreased emphasis on the government (a euphemism meaning other taxpayers), but this is, of course, a matter of opinion. According to my view of the world, the nation and its citizens will be best served by a social insurance system that follows certain principles.

- An individual should have as much freedom of choice as possible insofar as that is compatible with the interests of the nation as a whole.
- An individual should be afforded maximum opportunity and incentive to develop and use his abilities throughout his life.
- A government (federal, state, or local) should provide only the benefits that an individual (acting alone or as part of a group of individuals in some form of voluntary pooling or risk-sharing arrangement) cannot provide for himself. In meeting this responsibility, the government should become involved as little as possible, unless the interests of the nation as a whole are affected.

Our present Social Security has strayed from this philosophy. This variance has already taken its toll in terms of our citizens assuming less responsibility for self and family and depending more and more on government.

It must be borne in mind that a social insurance system, if not properly designed and communicated, can have three deleterious effects. First, it can effectively dictate the retirement age patterns of the nation and thereby encourage earlier retirement even if later retirement may be in the best interests of the nation. Second, it can discourage individual initiative and private saving for retirement, yet fail to provide adequate retirement benefits. Third, it can affect morale by creating unrealistic expectations for retirement. When the expectations are not met, frustration and dissatisfaction will follow. In my opinion, our present Social Security program exhibits these unsatisfactory characteristics in varying degrees.

The first of Ranson's axioms—economic efficiency—touches on the role of Social Security as a determinant of behavior, as a reflection of a culture, and as a determinant of a culture. I do not believe, however, that the axiom emphasizes these important roles sufficiently.

Simplicity

To be successful, a social insurance system must be simple enough for the majority of the population to understand, so that individuals can evaluate the system and then either accept or reject it. A system that is not clear, comprehensible, and communicable cannot endure.

The present Social Security system is so complex that the average person will never know what benefits to expect and hence will never know how much responsibility to assume for himself and his family. This lack of public knowledge will lead to the individual's looking blindly to the government, hat in hand, for whatever benefits "Big Brother" is dispensing. The inevitable results will be erosion of initiative, individuality, and self-respect, as well as the loss of a sense of freedom of choice and control regarding an important aspect of people's lives. Ironically, this system will also lead to the need for an even larger social insurance system, while it reduces the national capacity to finance such a system. Ranson's paper has an axiom called openness, which is virtually the same as my criterion of simplicity. I agree, of course, that even a simple system must be communicated effectively.

Fairness

To be successful, a social insurance system must be fair according to whatever principles of fairness are adopted. There need not be a

one-to-one correspondence between benefits and taxes. (Ranson advocates such a correspondence in his axiom of economic efficiency.)

To succeed, a social insurance system must not only be fair but be *perceived* as being fair; otherwise taxpayers will not support it. Both the benefits and the supporting taxes must be perceived as being fair. In fact, most measures of fairness are based on comparing benefits and taxes. Social insurance benefits are costly for a mature population in a mature economy. It is difficult enough to maintain taxpayer support for a system perceived as fair. It would be impossible to do so for a system perceived as unfair.

The cost of a pay-as-you-go system is relatively low in the early stages, particularly if the population and economy are growing. The cost of our Social Security system has grown steadily from less than 1 percent of payroll in 1940 to about 14 percent in 1983. It will continue to grow so that an onerous cost will always be a factor in whether the system is acceptable.

The present Social Security system has been represented to the public as being fair in an effort to gain and maintain public support. In reality, the present system is much less fair than it has been represented; it will not withstand much more scrutiny. From the standpoint of public acceptance, fairness may be the most important criterion. Ranson's paper does not have an axiom that deals explicitly with fairness, although his ideas of fairness seem to be woven into all four axioms. I believe that fairness should be a separate axiom.

Flexibility

Social Security is, in effect, a mechanism for dividing the population into two groups: those who work and produce goods and services, and those who are inactive but still share in the results of the production. A flexible system is needed that will permit this separation into active and inactive groups of persons to be self-adjusting with the changing times; that is, changing proportions of old and young, improved health at older ages, longer lifetimes, more women in the paid work force, and so on.

Social Security should also be flexible enough to accommodate changes in the family unit; in particular, it should accommodate the requirements of women moving toward greater independence and equality. The roles of men and women will continue to evolve; they will never again be as stereotyped as they once were. The present Social Security system is relatively inflexible. Furthermore, the public is understandably resistant to any change in benefits they believe they have bought and paid for. Ranson's paper gives no explicit

recognition to the principle of flexibility, but it is implicit in his four axioms.

Further Reflections on Criteria for Reform

A social insurance system does not exist in a vacuum. It is an integral part of a nation's culture. Accordingly, a social insurance system can satisfy the criteria just stated—or any other set of criteria—and still fail to work. For example, a social insurance system might be designed to satisfy only minimum basic needs, leaving it to the individual to provide the supplemental benefits necessary to maintain a preretirement standard of living. But if there are no reliable institutions through which an individual can save for retirement, the new system will not work. Or governmental policies, such as unfavorable tax policy and various inflationary policies, can thwart the ability of individuals to save effectively and render the new system impotent.

Accordingly, after criteria for reform are designed for the purpose of rationalizing Social Security, all other governmental policies must be revised to be consistent with the reform criteria. Only then will the social and economic environment be free to evolve toward consistency with the desired culture. This adds a new dimension of complexity to the task of restructuring Social Security, but unless this dimension is satisfied, Social Security reform cannot be carried out satisfactorily.

Ranson's paper contains two axioms that I did not include in my list of criteria: recognition of sunk costs and depoliticization. It seems to me that recognition of sunk costs is really a fairness issue, at least to the extent it advocates that present beneficiaries not have their benefits reduced. Ranson's suggestion that the "design of a new system has nothing to do with the liabilities that (rightly or wrongly) have been accrued in the past" is to me perfectly reasonable.¹ However, it raises the question of which accrued benefits should be preserved—those of current recipients, those of persons aged 55 and older, those of persons aged 30 and older, and so on.

Ranson's axiom of depoliticization suggests that Social Security should become immune from politics. I am not so sure this is desirable or, for that matter, even possible. Social Security is a composite of individual equity and social adequacy. We can separate these two elements of the program, and perhaps reduce the politicization some-

¹David Ranson, "Criteria for Reforming Social Security," *Cato Journal* 3 (Fall 1983):493.

what, but the social-adequacy feature will of necessity remain a political question. Even the individual-equity feature will remain political, in the sense that the design of the program will be a determinant of our individual and collective behavior. This feature will therefore be an important determinant of social and economic culture.

Conclusion

There is no reason for this country to continue with a social insurance system that is controversial, constantly on the verge of financial collapse, out of phase with the times, and—in my opinion—doomed to ultimate failure. Living with such a system is an unnecessary drain on our collective productivity and psyche. It is eminently more sensible for us to seek a social insurance system that is understood and perceived as fair and reasonable by the majority of the citizens, one that will be a solution to our national problem rather than a part of the problem itself.