FUNDED SOCIAL SECURITY: COLLECTIVE AND PRIVATE OPTIONS

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The present Social Security program bears some resemblance to an insurance program in that there is some positive, though weak, correlation between the taxes people pay and the benefits they receive. However, Social Security's vast network of transfers, in conjunction with the absence of any contractual relationship between participants and the government, also gives it many of the characteristics of a welfare program. For instance, one study of implicit rates of return on Social Security taxes found that people in the lowest quartile of lifetime earnings received three times more from Social Security per dollar of tax they paid, than did people in the highest quartile of lifetime earnings.[1] By now various scholars have pointed to the simultaneous existence of insurance and welfare elements within the Social Security program as the pivotal source of the difficulties that have increasingly come to plague the program. One of those scholars, Peter Ferrara, has referred to this confounding of insurance and welfare as Social Security's "inherent contradiction."[2]

When Social Security is diagnosed as suffering from programmatic schizophrenia, remedy clearly seems to require some separation into two programs—one to address the insurance element and the other to address the welfare element. This approach to diagnosis and remedy reflects a long-standing approach to problems of public policy in economics. The seminal articulation of this approach was presented

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[1]Alan Frieden, Dean Leimer, and Ronald Hoffman, *Internal Rates of Return to Retired Worker-Only Beneficiaries under Social Security, 1967–70*, Studies in Income Distribution, no. 5 (Washington, D.C.: Social Security Administration, October 1976), p. 17.

[2]Peter J. Ferrara, *Social Security: The Inherent Contradiction* (Washington, D.C.: Cato Institute, 1980). The same theme is pursued further in Ferrara's book, *Social Security: Averting the Crisis* (Washington, D.C.: Cato Institute, 1982).

by Jan Tinbergen, who argued that first the goals of policy must be selected and then different instruments or policies must be designed to achieve each of the chosen goals.[3] Although I am not a partisan of this approach to policy analysis (in part because the goals/instruments framework gives a misleadingly simplistic view of the processes of policy formation and implementation), I do nonetheless think that the distinction between insurance and welfare elements is useful for thinking both about present difficulties with Social Security and about possible approaches to remedy. My task in this essay is to explore some of the central properties of collective and private alternatives for the provision of retirement insurance. I do this under the presumption that it is sensible to distinguish between the provision of retirement insurance and the provision of welfare, so that questions about the former can be treated independently from questions about the latter.

Funding versus Pay-As-You-Go in Social Security

The economic theory of Social Security draws a central distinction between a pay-as-you-go system and a funded system. A funded system is one in which a person's contribution during his working years is placed in an investment fund. Upon his retirement, that person's contributions, plus accumulated interest, are converted into an annuity. What a person receives during retirement, then, depends upon the amount he contributed during his working years and the interest that those contributions earned. In contrast, a pay-as-you-go system is one in which a working person's tax payments are not invested but are paid out to retirees. What a retiree receives, then, does not depend upon the taxes he paid during his working years but rather depends upon the taxes that are paid by people who are presently working.

It is now becoming increasingly widely recognized that a funded system can, on a sustainable basis, offer people a considerably higher rate of return on their payments than they could receive from a pay-as-you-go system. Under a mature pay-as-you-go system, retirees can receive an implicit return on their earlier tax payments that is equal to the rate of growth in the tax base, which in turn is the sum of the

[3]Jan Tinbergen, *On the Theory of Economic Policy* (Amsterdam: North-Holland, 1952). The tacit assumption of benevolent despotism that informs this common approach to economic policy is certainly questionable under contemporary democratic regimes. For an effort to approach public policy within the explicit context of a democratic regime, see Bruno S. Frey, "Eine Theorie demokratischer Wirtschaftspolitik," *Kyklos* (1978):208–34.

rate of growth in the labor force and the rate of growth in real wages per worker.[4] Historically, this potential rate of return has been in the vicinity of 3 percent, although this rate may be lower in the future. For one thing, declining fertility rates portend a slower rate of growth in the labor force. They may even portend an actual decline; this will happen if the fertility rate continues below the replacement rate without being offset by immigration. In addition, the slowing in the rate of growth of real income that has occurred over the past decade or so may continue into the future.

With a funded system, the rate of return that participants can receive depends on the yield from investment. Historically, this has run in the range of 10 to 12 percent before tax. Hence, a funded system would seem to be three or four times better than a pay-as-you-go system. However, retirees could not actually receive this superior return (at least at present), because the yield on saving is taxed. Although the rate at which saving is taxed depends on the circumstances of individual savers, a rate in the general vicinity of 75 percent is not uncommon. Saving that is invested in business enterprise, for instance, is taxed in at least three ways: through the local property tax and through federal and state taxes on both corporate and personal income. Per $100 of income from saving, local property taxes can easily amount to $20. Of the $80 that remains, federal and state corporate taxes can easily claim $30. And of the $50 that then remains, federal and state personal income taxes can easily claim $25, thus leaving $25 of the original $100.

A rate of tax in the vicinity of 75 percent places the post-tax yield on saving in the same range as what a mature pay-as-you-go system would yield. But even if retirees receive the same return under either system, the funded system is still superior socially, because the added tax revenues represent a gain to the nonretired citizenry, as these people would have to bear less of a tax burden to finance government than they would under a pay-as-you-go system. Or alternatively, by eliminating the taxation of saving—thereby treating saving and consumption equally—the nonretired citizenry will be treated identically under the two systems and retirees will receive a higher return under funding.[5]

[4]"Implicit" is attached to "return" because the return does not represent the yield on capital assets, as it does in normal usage. Indeed, there is an implicit return even though the effect of the pay-as-you-go system is to destroy capital and income.

[5]Relatedly, a pay-as-you-go system of Social Security seems to have a substantial negative impact on saving and capital formation. What workers contribute under a funded system is saved, but the taxes they pay under a pay-as-you-go system are transferred to retirees, to finance their consumption. As a first approximation, the amount of taxes collected under a pay-as-you-go system of Social Security represents the amount of

Despite the considerable superiority of a funded system, the present pay-as-you-go system has enjoyed great popularity to date.[6] In part this might be attributed to the high taxation of private saving that strongly restricts the ability of people to get the substantially higher returns their saving produces. But the dominant reason for Social Security's popularity is surely the consequence of its very immaturity. In the early years of a pay-as-you-go system, retirees get high returns with low taxes. As late as 1947, the maximum yearly tax that could be extracted from someone was $60, so it is no wonder that implicit rates of return could exceed 1,000 percent for some people. Those large returns were made possible because retirees paid little tax and the tax base was growing rapidly due to increasing tax rates and extensions in the number of people covered by the tax. Until 1983, the United States was in the initial phase of its pay-as-you-go system: Present retirees spent less than a full working life paying taxes and had the advantage of being retired while the grasp of the tax was continually widened and its rate continually increased.

We are only now starting to enter the mature phase of our pay-as-you-go system. Only now will there start being significant numbers of people retiring who have spent their entire working lives paying Social Security taxes. And another generation must pass before we will be fully into a mature pay-as-you-go system, at which time the predominant number of retirees will have spent their working lives under the system, will have done so at relatively high rates of tax, and will not be able to gain from expansions in the number of people covered by the tax. Some projections of Social Security tax rates see those rates in the vicinity of 40 percent within half a century.[7] The point of such projections is not, of course, that such rates will actually

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additional saving that would have been forthcoming under a funded system. This additional saving would have increased the capital stock, which in turn would have increased productivity and income.

Martin Feldstein has estimated that the reduction in saving and capital formation due to the pay-as-you-go system of Social Security has reduced real income by about 15 percent. His seminal work here is "Social Security, Induced Retirement, and Aggregate Capital Accumulation," *Journal of Political Economy* 82 (September/October 1974):905–26. Although Feldstein's estimate has generated much controversy, this controversy has come to center more on the particular empirical magnitudes (which of necessity are constructions in conjectural history) than on the qualitative point that a pay-as-you-go system entails some reduction in saving and capital formation as compared with a funded system.

[6]For an examination of possible sources of this popularity, see William C. Mitchell, *The Popularity of Social Security: A Paradox in Public Choice* (Washington, D.C.: American Enterprise Institute, 1977).

[7]See the projections presented in A. Haeworth Robertson, *The Coming Revolution in Social Security* (Reston, Va.: Reston Publishing Co., 1981), p. 51.

come to pass, but that the present course of Social Security cannot be maintained, precisely because those rates of tax are exceedingly unlikely to be tolerated by even the most quiescent of taxpayers at that time.

What will replace the present system, obviously, remains to be seen. A funded system is clearly superior, for as a sustainable system it offers returns that are several times higher than a pay-as-you-go system can offer. But suppose the retirement component of Social Security were to be placed on a funded basis. How would a governmentally operated system of funded retirement insurance compare with the provison of such insurance through a network of competitive, private suppliers? There are, of course, various questions that would have to be addressed concerning the transition from the present to a funded system. The specific way this might be done is not of central importance in comparing governmental and private alternatives. To some extent the unfunded liability might be reduced by such reductions in anticipated future payments as increasing the retirement age and shifting the basis for indexing benefits from wages to prices. What remains of the unfunded liability could be treated as an explicit government debt, with that amount accordingly borrowed by the government and transferred to the Social Security fund. From then on, Social Security would be operated on a funded basis, with retirees living off their own contributions plus interest. But my central task here is not to consider how the transition from pay-as-you-go to funding might take place; rather it is to compare government funding with private provision, under the presumption that the transition can be made in one way or another.

What Rules for Governing a Funded System?

It would always be possible to conceive of a funded program of Social Security operated by government as simply one among many such programs, with all of those programs operating under the same legal rules. Government would simply be one among many competing suppliers of retirement annuities, and people would be able to choose whichever supplier they preferred. Moreover, there would be neither tax provisions nor regulatory requirements that pertained to the private suppliers but not to the government's program. Principles of legal liability and residual claimancy would pertain equally to the government's program and to the private programs.

But as long as government is regarded as a maker of law for others rather than as being simply one participant in a system of law that itself is made by other, consensual processes, it is inconceivable that

a funded system operated by government would truly be grounded in principles of property and contract.[8] This is certainly the central point to be inferred from the 1960 ruling of the Supreme Court in *Flemming* v. *Nestor*.[9] In the spirit of *Flemming*, people would not have rights of property and contract that they could enforce against congressional infringement. A person could not, for instance, bring an action against Congress on the grounds that it was mismanaging the plaintiff's assets, with evidence on this point being the significantly higher return that those assets could have earned by having been invested in some random sample of private funds. Similarly, Congress would have the ability to create rules that would place private competitors at various disadvantages, not the least of which would be a requirement that everyone make at least some minimum investment with the government fund. I take it for granted, then, that if the government operates a funded system of Social Security, that fund will have some monopoly status and most definitely will not be simply one among many funds all competing under principles of legal equality.

Should government undertake to institute and operate a funded system of Social Security, the performance characteristics of that system would depend upon the type of rules under which that system would be constituted. There are several obvious types of problems with which a funded system operated by government would have to deal, in one way or another. A funded system would be a product of legislation and would be operated by some government bureau. Accordingly, a funded system would confront various problems of legislation and administration, many of which have come increasingly to be elucidated upon in the recently developing literature on the economics of legislation and bureaucracy.

Incentives for Capital Dissipation

The present system of Social Security was, of course, chosen by Congress, and Congress could have chosen to establish a funded system instead. Indeed, Social Security began essentially as a funded system. Moreover, the legislation that established the Social Security program came quite close to allowing people to contract out of Social Security. The original Senate version allowed people to contract out, but the House version did not, and contracting out died in the

[8]On different social processes for the production of law, see Bruno S. Leoni, *Freedom and the Law* (Los Angeles: Nash Publishing Co., 1961).
[9]363 U.S. 603.

conference committee.[10] Any such provision for contracting out would have constrained the funded nature of Social Security still further, for otherwise the government's program could not have survived in the presence of a provision for contracting out.

However, by 1939 Congress began to dissipate the fund that had been accumulating, by increasing the benefit payments that were made to people who had contributed practically nothing to the fund. There seems to be little basis at present for being optimistic that Congress might choose to create a funded system of Social Security. There is perhaps even less basis for being optimistic that such a system, once created, would be operated and maintained as a truly funded system. The modus operandi of a funded system seems to run counter to the known proclivities of legislatures to spend all that is available to them, and then some.

Suppose a funded system were established in, say, 1985. What would prevent this system from being converted to a pay-as-you-go system by, say, 1992, through amending legislation of the 102d Congress? The arousal of temptations for capital dissipation in the face of an accumulating fund is an inherent feature of prevailing political institutions, in which government is not itself subject to rights of property and contract but rather is able to continually act as an abridger of those rights through its powers of taxation and regulation. Whether a future Congress would choose to replace the choice of a previous Congress to put Social Security on a funded basis, by shifting to a pay-as-you-go basis, depends on the array of political forces at that future date.[11]

Imagine a situation a few years after a previous Congress had placed Social Security upon a funded basis, and consider how a proposal to shift to a pay-as-you-go basis would affect different people. For people who are already retired, the change would offer increased benefit without cost. Those people would receive more than their own contributions plus interest, because they would also receive some support from the tax payments of current workers, but they would not be liable for tax. People close to retirement will bear some cost through higher taxes but will gain even more through participating in the dissipation of the fund. As age declines, a break-even point will be reached, after which the gains from participating

[10]For this bit of history, as well as a thorough treatment of the overall development of Social Security, see Carolyn L. Weaver, *The Crisis in Social Security: Economic and Political Origins* (Durham, N.C.: Duke University Press, 1982).

[11]See the discussion of this general point in Edgar K. Browning, "Why the Social Insurance Budget Is Too Large in a Democracy," *Economic Inquiry* 13 (September 1975): 373–87.

in the fund's dissipation will be outweighed by the losses incurred through higher taxes and less future income.

In a setting in which one-third or so of the adult population is retired, it would not take the support of too many additional people to constitute a majority. This is reinforced by the higher rate of voting among the retired: More than two-thirds of those above age 65 voted in the 1980 general election, while the overall voting rate was just over 50 percent. Hence, there is certainly no basis for thinking that just because one Congress places Social Security on a funded basis, subsequent Congresses will continue with that choice. Unless people have enforceable claims to their own contributions, a switch to a pay-as-you-go basis is likely to prove irresistible eventually, because it would offer gains to a dominant subset of the citizenry.

Even if one Congress does establish funding as a basis for Social Security, subsequent Congresses are not bound to maintain that basis. Consequently, any effort to institute a governmentally operated system of funding will require some means of preventing subsequent dissipation of that fund. But since one Congress cannot bind its successors, and since it is inconceivable that the government fund would be operated as simply one fund among many under a general rule of law, the ability of some subsequent Congress to dip into the fund could be foreclosed only by giving the fund some type of constitutional standing. There has, of course, been a growing interest in inherent legislative biases toward spending and toward shifting burdens from the present to the future through deficit financing, as well as possible constitutional constraints to limit those biases.[12] There has also been a growing recognition that legislatures can be truly creative in evading the intent of those constraints; for instance, much of the growth of off-budget activity by state governments has been a response to balanced-budget requirements.[13]

What Rules for Managerial Conduct?

Even if it were possible to develop rules, constitutional or otherwise, that would prevent subsequent capital dissipation, a further consideration arises concerning the efficiency with which the funded system would be operated. The return that a funded system, as well

[12]On balanced-budget requirements as a possible constraint on the proclivity of legislatures to mortgage the future for present gain, see James M. Buchanan and Richard E. Wagner, *Democracy in Deficit: The Political Legacy of Lord Keynes* (New York: Academic Press, 1977); and Robert D. Tollison and Richard E. Wagner, *Balanced Budgets, Fiscal Responsibility, and the Constitution* (Washington, D.C.: Cato Institute, 1980).

[13]This subject is examined in James T. Bennett and Thomas J. DiLorenzo, *Underground Government: The Off-Budget Public Sector* (Washington, D.C.: Cato Institute, 1983).

as a private alternative, will yield will obviously depend on the performance of the assets that the fund owns. Various investment funds differ in their rates of return over any particular period. Some of this variation is surely due to variation in managerial quality and performance. Market processes of competition in the context of residual claimancy generally promote the replacement of poorer management with better management. This takes place either directly, through the actual replacement of one set of managers with another, or indirectly, through the decline of poorly managed firms and the growth of well-managed firms.

But some of this variation in rates of return over any particular period can also reasonably be attributed to genuine uncertainty about the future performance of different possible investments. Even in a competitive system of investment firms that are providing retirement annuities, some of them will earn higher returns over any particular period than others will, and for reasons having nothing to do with the effort and the quality of management but having to do only with circumstances that truly could not be foreseen.

It cannot be claimed that each private supplier of retirement annuities will yield as high a return as possible, in light of the preferences of investors for risk and the like, but the market process will tend to replace less efficient with more efficient management. The operation of a funded system of Social Security by government raises new questions of incentive that have been explored in the recent literature on bureaucracy.[14] In comparing the conduct of profit-seeking firms and governmental or other nonprofit agencies, the presence or absence of residual claimancy creates an additional and systematic source of variation in conduct. In a profit-seeking firm, there is some person or are some persons—such as stockholders of corporations—who bear a status of residual claimancy, which means that these people bear the consequences, for good or for ill, of "unforeseen" events. There are two categories of "unforeseen" events. One deals with events that arise because the observer was either relatively incompetent or relatively inactive. The other refers to events that arise even though the observer was both competent and active.

A status of residual claimancy creates a strong incentive to avoid the "unforeseen" events that would arise through incompetence or inactivity. Nothing can be done, of course, about events that would arise through genuine uncertainty. This incentive to avoid unforeseen events is weaker under a nonprofit or collective form of

[14]For a brief survey of this literature, see Richard E. Wagner, *Public Finance* (Boston: Little, Brown & Co., 1983), pp. 108–28.

organization, because any gain or loss is not concentrated on particular residual claimers but rather is diffused throughout the relevant population.

This property of differing ownership arrangements has by now been studied for various cases. Some interesting and pertinent data for the case at hand may perhaps be gleaned by comparing the investment performance of foundations to that of mutual funds. Foundations are more akin to government under a funded system, while mutual funds are more akin to individual firms in an industry of private providers of retirement annuities. Using data for 1968, the Commission on Foundations and Private Philanthropy found that foundations received an average return on their portfolios of 5.6 percent, whereas mutual funds received an average return of 15.3 percent.[15] Similarly, the rate of turnover of foundation portfolios ran in the vicinity of 1 to 2 percent, whereas it was about 10 times higher for mutual funds.[16]

The return that people might get under a funded system of Social Security clearly seems to depend on the incentives that managers of the fund possess. A system in which managers are paid only by salary would differ significantly from one in which they are paid to some extent through some type of profit-sharing payment. Besides depending on incentives, the return that a funded system will offer will depend on the constraints imposed on fund managers regarding such things as their ability to reward and penalize subordinates. It is by no means clear that a funded system, even if it can be kept intact, will give people as good a return as they could expect to get through a system of competing private suppliers. Indeed, under prevailing institutional arrangements and the incentives these entail, it seems exceedingly unlikely that a funded system operated by government will perform as well for people as a system of competing suppliers.

Funding and Government Regulation of Credit Markets

Under a funded system of Social Security, the federal government would become the dominant supplier of saving in credit markets. Under present conditions, the federal government would supply in the vicinity of 50 percent of all saving. There would probably be few if any areas where some money could not be attributed to government's Social Security fund. Government money is, of course, a

[15]Commission on Foundations and Private Philanthropy, *Foundations, Private Giving, and Public Policy* (Chicago: University of Chicago Press, 1970), pp. 74–75.

[16]Moreover, in this particular case the difference was substantial. With foundation assets at the time in the $20-to-30-billion range, the lost income of $2 to 3 billion annually was roughly equal to the actual amount of foundation giving.

prominent instrument by which the federal government gains some control over activities that are not under its constitutional authority. For example, we have a long record of how conditional grants-in-aid have been used by the federal government and by the various participating interest groups to circumvent the constitutional allocation of responsibilities between the federal government and the states. Thus we have the federal government setting speed limits on highways and regulating advertising alongside highways, even though constitutionally highways are clearly the province of the states.

The presence of federal money does not always lead to regulation, it might be noted. The case of Hillsdale College might be thought of as setting some limits here.[17] This case might be thought to show that if the link or route between the federal government and some activity the government wants to regulate is too remote or circuitous, the government will be unable to use money as justification for regulation. Although Hillsdale College took no money directly from the federal government, some of its students received such money. The federal government used this relation between it and those students in an effort to force Hillsdale to comply with various federal regulations. Hillsdale was upheld in this case; hence it might be thought that there are at least some limits on the power of the federal government to use some presence of federal money as a means of extending its regulatory reach. However, it should also be noted that Hillsdale incurred considerable costs in defending itself, and in a case that was clearly absurd. In how many equally absurd cases would defendants acquiesce because of the high cost of defense?[18] If anything, the Hillsdale case is surely the proverbial exception that proves the rule: The presence of federal money serves as an entering wedge for the federal regulation of areas not constitutionally subject to such control.

Whether such a wedge is actually used in particular cases, and how it will be used, will depend on the costs and gains perceived by the various participants involved. For example, Davis-Bacon type provisions could be extended throughout the construction industry as federally supplied saving became diffused throughout the construction and mortgage markets. It is not unimaginable that multifarious requirements regarding the design of buildings, the

[17]*Hillsdale College* v. *Department of Health, Education and Welfare et al.*, 696 F.2d 418 (6th Cir. 1982).

[18]For a general treatment of the possibly negative relationship between personal liberty and government spending, see Roland N. McKean, *Public Spending* (New York: McGraw-Hill, 1968), pp. 107–24.

purposes that they must or can serve, and numerous other demands would be similarly imposed. What particular impositions might emerge would depend upon the particular identity of the highest bidders for legislation in a given situation.[19] It might be required that houses be built at least partially underground. It might be required that apartment complexes be required to house a mix of residents by such characteristics as income, race, and family size. The possibilities would be limited only by one's imagination and by the strength of the costs and gains to various people of seeking favorable legislation and of opposing unfavorable legislation.[20]

The Ultimate Impossibility of Collective Funding

Any effort to operate a funded system of Social Security through government would have to develop various rules to ensure that the fund would perform as well as a competitive system of private providers of annuities. And despite the most strenuous efforts to this end, this effort seems unlikely to succeed. Indeed, there is an important body of economic literature that suggests that it would be impossible for a funded system to be operated as efficiently as a competitive system of private suppliers, because both the knowledge and the incentive required for such a task would be absent. This is the central conclusion of the economic theory of socialism, which is sometimes known as the theory of economic calculation.

That theory, which originated in the 1920s, stemmed from socialist proposals to replace markets with planning as the means of resource allocation, for only in this manner could commodity production be abolished and alienation overcome. Ludwig von Mises succeeded in showing that in such a socialist system it would be impossible for the structure of production to adapt efficiently to consumer wants, because the knowledge necessary for economic calculation could not be generated.[21] The subsequent socialist literature did not argue that the prevailing pattern of consumer wants was irrelevant because it reflected the capitalist process of commodity production. Instead, this literature retreated from the abolition of markets and proposed instead some variant of what was called market socialism, which (as

[19]On legislation as an ordinary economic activity, see Robert E. McCormick and Robert D. Tollison, *Politicians, Legislation, and the Economy* (Boston: Martinus Nijhoff, 1981).

[20]Indeed, the leverage that a funded system of Social Security might offer for an extension of federal regulation may well be seen by some people as an argument in favor of funding, even if they were not concerned or convinced about the negative impact of a pay-as-you-go system on saving and capital formation.

[21]See the essays collected in Friedrich A. Hayek, ed., *Collectivist Economic Planning* (London: Routledge and Kegan Paul, 1935).

Paul Craig Roberts noted) was hardly socialism at all, because commodity production was maintained; instead, this system represented "a polycentric system with signals that are irrational from the standpoint of economic efficiency."[22]

As a result, the existence of a market process became widely recognized as an essential condition for economic calculation. What was not so widely accepted was whether economic calculation could take place in a quasi-market order in which there existed collective ownership of capital goods. Within a static-equilibrium framework, there seemed to be no essential difference between the abilities of capitalist and socialist economies to solve the problem of economic calculation, considering that socialism now referred to commodity production for markets instead of production for use in the absence of markets, as it had meant before von Mises' critique. It is not surprising that the adoption of different perspectives toward the nature of the economic process resulted in different formulations of what was required for economic calculation.[23] A model of static equilibrium made the task of economic calculation under socialism appear simple and straightforward, as embodied in suggestions that socialist managers be instructed to set price equal to marginal cost. Within a model of static equilibrium, it is presumed that knowledge can be described fully, like the cards dealt in a poker game, and the problem of economic calculation is simply one of getting consumers and producers to say truthfully just what cards are in their hands.

But once it is recognized that knowledge has, among other things, a substantial tacit component, the abilities of external observers to judge whether someone is properly using knowledge disappears, and emphasis can no longer be placed on methods that are predicated on explicit knowledge.[24] Instead, what must take place is a shift of

[22]Paul Craig Roberts, *Alienation and the Soviet Economy* (Albuquerque: University of New Mexico Press, 1971), p. 84. See also idem, "The Polycentric Soviet Economy," *Journal of Law and Economics* 12 (April 1969): 163–79; and idem, "Oskar Lange's Theory of Socialist Planning," *Journal of Political Economy* 79 (June 1971): 562–77.

[23]For a careful examination and discussion of this point, see Karen I. Vaughn, "Economic Calculation under Socialism: The Austrian Contribution," *Economic Inquiry* 18 (October 1980): 535–54. For a symposium on the theory of economic calculation, see the entire issue of the *Journal of Libertarian Studies* 5 (Winter 1981), particularly the first three essays: David Ramsey Steele, "Posing the Problem: The Impossibility of Economic Calculation," 7–22; Robert Bradley Jr., "Market Socialism: A Subjectivist Evaluation," 23–29; and Don Lavoie, "A Critique of the Standard Account of the Socialist Calculation Debate," 41–87.

[24]Michael Polanyi has aptly summarized the distinction between tacit and explict knowledge: "Things of which we are focally aware can be explicitly identified; but no knowledge can be made *wholly explicit*. . . . Hence, tacit knowing is more fundamental

focus to the properties of different processes for making use of such nonarticulatable but real phenomena as tacit knowledge. In this regard, the theory of economic calculation explains that any such process must contain the central institutional elements of property, contract, and residual claimancy. Prices, which arise through contract, are an important source of the knowledge necessary for effective economic conduct. They are also an important source of incentive, for in conjunction with residual claimancy they provide a means of rewarding effective action and penalizing ineffective action.

A funded system of Social Security runs counter to the basic requisites of economic calculation, unless such a system were simply one option among many, with the governmental option being given no advantage by government over the other options. It is impossible to determine what would constitute an efficient program or set of programs independent of a competitive market process operating within a framework of property, contract, and liability. Consequently, there is no set of administrative rules or legislative constraints that could be articulated that would be capable of assuring efficient outcomes. This is analogous to the point that it is impossible for any external observer to discern whether a particular public enterprise is adhering to a rule of setting price equal to marginal cost. Cost is the anticipated value of the option that is necessarily given up to secure the option in question. While people may come to form the same anticipation in a truly static economy, no such identity of anticipations is possible in the presence of continuous change. When people differ in their assessment of future possibilities, the marginal cost of any particular action will depend on individual judgments regarding the future.[25] Therefore, an instruction to set price equal to marginal cost will give no clear guidance, which means, among other things, that there is no objective means of checking the compliance of managers with some rule of setting price equal to marginal cost.[26]

People can reasonably differ in their anticipations regarding such pertinent future circumstances as patterns of mortality, effects of

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than explicit knowing: *we can know more than we can tell and we can tell nothing without relying on our awareness of things we may not be able to tell.*" See Michael Polanyi, *Personal Knowledge* (London: Routledge and Kegan Paul, 1958); Polanyi's emphasis at p. x of Torchbook edition, 1964.

[25]On the subjectivity of cost, including a consideration of the implications of such subjectivity for economic calculation, see James M. Buchanan, *Cost and Choice* (Chicago: Markham, 1969).

[26]See, for instance, the thorough discussion in Jack Wiseman, "Uncertainty, Costs, and Collectivist Economic Planning," *Economica* 20 (May 1953):118–28; reprinted in James M. Buchanan and G. F. Thirlby, eds., *L. S. E. Essays on Cost* (London: Weidenfeld and Nicolson, 1973).

medical science upon physical vigor, destructiveness wrought by a future war, as well as differing in anticipations about possible social innovations and practices. (For example, the development of insurance was one such innovation in the past, and the replacement of extended families in rural settings by nuclear families in urban settings was one such relevant practice or condition.) Consequently, there is no uniquely correct view of the future, even if all people are of the same mind. And this lack of uniqueness is strengthened once it is admitted that people may differ in their own evaluations of those different possible states. Hence, an efficient approach to retirement insurance cannot be assessed except as it emerges through a consensual process based on the institutions of property and contract—this is the central theme of the theory of economic calculation.

If the insurance and welfare components of Social Security are separated, the efficient provision of those annuities can only take place within some type of truly consensual or contractual institutional order. A requirement that people belong to the governmentally funded system renders efficient provision impossible, for such an approach to provision runs afoul of the essential requirements for economic calculation, because knowledge would be destroyed and incentive weakened. There is no particular reason for being opposed to governmental operation of a particular program or plan for retirement annuities, as long as the government fund competes on equal terms with other funds. But if the government fund were to acquire a favored, monopolistic status, either by requiring participation or by imposing strong enough regulations on private funds to render those offerings generally inferior to those of the government's fund, the requisites for economic calculation would have been erased. Thus, the general assurance that people are getting the best deal they can on their savings would have vanished.

Actuarial Fairness and Competitive Provision

It is often claimed that the market provision of retirement annuities could not take place in an actuarially fair manner. Kip Viscusi and Richard Zeckhauser, for example, argue that "because of large transactions costs and problems of adverse selection, private annuities are not available on an actuarially fair basis."[27] But what is an actuarially fair basis? An actuarially fair amount to pay for a gamble that pays $6 upon guessing the correct number of a single throw of a die is $1—

[27]W. Kip Viscusi and Richard Zeckhauser, "The Role of Social Security in Income Maintenance," in *The Crisis in Social Security* (San Francisco: Institute for Contemporary Studies, 1977), p. 52.

as a first approximation. As a closer approximation, the actuarially fair amount to pay would be somewhat higher than $1, because the price of the bet must also cover the cost of organizing the game.

But what is actuarial fairness in the provision of retirement annuities? Suppose that people have on average a life expectancy of fifteen years when they are age 65. Assuming, for computational ease and without distorting the central point, that the rate of interest is zero, people who have accumulated $300,000 by age 65 should be able to buy annuities that pay them $20,000 per year. This is an actuarially fair annuity—as a first approximation. But what about a closer approximation? For instance, is it necessarily actuarially unfair if someone is offered only a $15,000 annuity? Not necessarily, for there are a number of reasons why this might happen without violating the presumption of actuarial fairness. One obvious factor is the cost of operating the insurance enterprise, which reduces the annual payments that can be financed from a given capital sum, as compared with what would be possible under a regime of zero transaction costs. But in the real world, these costs of operation are a necessary part of the process of promoting actual actuarial fairness.

Another possible factor concerns anticipations of possible future longevity. What is relevant is the average age at which people who are presently 65 will actually die, and not a recent history of the average age of death of those who had actually lived to age 65. Anticipations pertaining to such things as international affairs and public policies are also relevant in governing the terms of trade between a capital sum and an annuity promise. Once anticipations about the future enter, there is no unique notion as to what constitutes actuarial fairness. There is no way any outside observer can say whether or not a particular offer of an annuity is actuarially fair, because the quality of fairness depends, among other things, on people's present anticipations about what things will be like in the future, as well as on their preferences for or against bearing the uncertainty that is inherent in any market for annuities. All that can be said is that a competitive process of providing annuities will tend to create a set of offerings that represents the best deal that people are willing to agree to.

Adverse selection does not upset the case for competitive provision. People who recognize that they have traits strongly associated with longevity will have a stronger-than-average interest to participate, if they can participate on the same terms as others. Competition will tend to bring about a zero-profit equilibrium in any event. Suppose there are traits other than age that affect longevity—traits known only to the particular individuals and not to potential insurers; and

further suppose that it would be impossible for insurers to discern those traits. As compared with a standard of omniscience, the market provision of annuities would favor those who had traits conducive to longevity. Those with long life expectancies will get annuities on more favorable terms than if insurers knew the "truth" about them. In like manner, those with shorter life expectancies will get annuities on less favorable terms. This differential in treatment, however, is inherent in the absence of omniscience, and could not be corrected by a governmentally operated system of funding.

Alternatively, suppose it is possible for insurers to gain knowledge about some of the traits besides age that influence longevity. The process of competition in a competitive market for annuities will tend to induce the collection and utilization of the added information as long as the gain from the more accurate classification of people exceeds the cost of that information. As a result, the differential in treatment of people with significantly different life expectancies will diminish. Such a differential will never vanish, of course, because omniscience would be necessary for that to happen, as a unique annuity would be applied to each person. And there is nothing in collective provision that would be able to promote a more effective production and utilization of information. Indeed, actuarial unfairness seems more likely to be encountered in a governmentally operated system of funded Social Security than in a system of private suppliers. In the absence of omniscience, people must be placed into categories. As noted above, such categorization will proceed as long as the gains in the form of added business exceed the cost of refining those categories. One particular implication of the zero-profit character of competitive equilibrium is that the supply of annuities from a competitive industry will tend to produce as much actuarial fairness as is efficient in light of the cost of knowledge.[28] By contrast, in a governmentally operated funded system, less knowledge would be generated about future possibilities, and moreover, in the absence of competition there would be a stronger likelihood of politically based discrimination among people. If actuarial fairness is desired,

[28]On this distinction between reasoning on the basis of a presumption of omniscience and reasoning on the basis of a presumption of ignorance combined with social processes for utilizing limited knowledge through a network of markets, see the extraordinarily cogent treatment by Thomas Sowell in *Knowledge and Decisions* (New York: Basic Books, 1980). This line of inquiry descends directly from several of the essays reprinted in Friedrich A. Hayek, *Individualism and Economic Order* (Chicago: University of Chicago Press, 1948), particularly the essay "The Use of Knowledge in Society."

competitive provision and not government provision is the only possibility: This is a corollary of the theory of economic calculation.

What Regulation for a Private System?

In thinking about a system of competitive producers of retirement annuities, the question of regulation must be faced. Such programs as Individual Retirement Accounts and Keogh plans entail legislation that gives them tax-exempt status and regulation that restricts such things as the types of permissible investments and the ability of people to alienate their ownership. Like regulation generally, some types of regulation of the suppliers of retirement annuities might provide general gains to all, while other types of regulation might be generally harmful but provide benefits to particular sets of people at the expense of everyone else. A proliferation of the latter type of regulation can, of course, undo much of the advantage of a competitive system, by lowering the rates of return that people can receive. Regulation can also be used to force transfers of income among the participants of an ongoing system, as with the recent efforts to abolish sex as information on which annuity contracts may be based. It is certainly possible that a regulated system of private insurance will look quite different from a genuinely competitive system, and furthermore will not operate very differently from a governmentally operated system. In any event, any eventual consideration of the competitive provision of retirement annuities must confront the question of regulation.

Forced Saving

The only aspect of such possible regulation I wish to consider here is the near-universal acceptance of the proposition that people should be required to contribute a minimum percentage of their income to some such fund. The life cycle of people is almost universally one in which they are substantial net borrowers during their early years of work, as they have relatively low earnings along with relatively high expenses associated with such things as buying houses and raising children. It is only during their middle years of life that people typically become net savers, when their incomes are in their peak range, their children are on their own, and so on. In the absence of a requirement that they contribute to a retirement fund throughout their working lives, people typically would not start saving for their retirement until they reached this middle stage of life.

A requirement that people must save at the same rate throughout their working lives obviously interferes with the life-cycle plans of

most people. Furthermore, this interference entails both a social waste and a transfer of income to particular beneficiaries of such a regulation. A requirement that people save throughout their working lives leads people to increase their borrowing during their early years— and by an amount that roughly offsets the required savings. Since the price at which people can borrow exceeds the return they can get on their forced saving, these people will be worse off. Some of their loss may represent an offsetting gain to the owners of financial institutions. This will happen to the extent that financial regulation promotes industry monopoly. In this case, some of the difference between rates paid by borrowers and rates paid to savers represents monopoly profit within the industry. Additionally, part of the spread between borrowing and lending prices reflects the cost of resources involved in the administration of such credit transactions. For the transactions that would have been unnecessary because internal finance would have been used in the absence of forced saving, the result is a social waste, as people use up resources in undoing the effect of that regulation.

Requiring people to save for their retirement when they are in a stage of life in which they are raising families and in which their incomes are increasing relatively rapidly toward their peak range, then, does two things: (1) It taxes such people for the benefit of the owners of financial institutions; and (2) it involves a waste of resources, because resources become employed in undoing what the regulation sought to accomplish, but could not—namely, a rearrangement of intertemporal patterns of saving and borrowing. In recognition of this property of this type of regulation, one might wonder whether an alternative rule might not be preferable, say one in which mandatory saving takes place only after, say, age 40. But even this approach cannot accommodate the substantial differences that exist in the circumstances of different people. Some may have children early in life, others later. Some may have none. While life-cycle patterns of income generally show an inverted U-shape in relation to age, there is much variation in the timing of peak ranges among both individuals and occupations. No rule can accommodate such circumstances as fully as people can accommodate them by acting on their own behalf through a regime grounded in property, contract, and liability: This also is a corollary of the theory of economic calculation.

Shortsightedness

So why have any regulatory rules at all, at least with respect to a required pattern of saving? Why not allow people to choose to provide for their own futures as they think best? It is often asserted that

substantial numbers of people will fail to provide for their retirement, in the absence of compulsion to overcome such shortsightedness. If such shortsightedness is thought to be general throughout the population, the entire case for democratic government would, of course, seem to vanish. If people are generally incapable of projecting the future with regard to providing for their retirement, they are surely at least as incapable of making choices among competing candidates for political office, because many of the facets of such a choice require a similar projection of the future.

But if it is thought that such defective foresight plagues only some people, one might wonder why the prudential remainder of the citizenry should bear the burden of being unable to develop and choose preferred courses of personal provision because of the shortsightedness of a few. One might equally well wonder whether such a regulation is really a means not of counteracting defective foresight but of transferring income to financial institutions.[29] For instance, evidence presented by Carolyn Weaver suggests that in the period before Social Security, the problem of dependency among the aged was small.[30] In New York State in 1929, nearly 95 percent of people over age 65 were self-supporting. Moreover, in a number of surveys of the elderly in different cities over the 1925–29 period, fewer than 10 percent were regarded by government commissions as in need of assistance. Moreover, most of the source of low standards of living among the elderly was attributed not to shortsightedness but to low incomes throughout their working lives.

Indeed, basic economic analysis suggests that what might appear to be shortsightedness is really just a rational response to existing opportunities that reward people for failing to provide for their futures. It is costly to provide for one's future, and the less costly a failure to do so becomes, the less people will make such provision. In other words, Social Security would promote a rational response that might be characterized as shortsightedness. This interpretation seems far more consistent with both history and reason, and moreover is just another manifestation of the proposition that people reduce their saving in response to Social Security.

Thomas Szasz' work *The Myth of Mental Illness* seems to have much pertinence here, particularly his chapter on "The Ethics of

[29]This is the approach increasingly taken by the economic theory of regulation: "The announced goals of a policy are sometimes unrelated or perversely related to its actual effects, and the *truly intended effects should be deduced from the actual efforts*." George J. Stigler, *The Citizen and the State* (Chicago: University of Chicago Press, 1975), p. 140 (author's emphasis).

[30]Weaver, pp. 41–44.

Helplessness and Helpfulness," where he notes: "Not only do some Biblical rules foster dependency; they also lay the groundwork for using lack of foresight and incompetence as weapons to coerce others to provide for one's needs."[31] It is not that people are inherently shortsighted but that they will act in that manner if it pays to do so. Moreover, there is a payoff to those directly involved in covering up the consequences of such shortsightedness, as long as the means to do this are extracted from others through taxation, as against being supplied directly by those so involved. It seems, in other words, to be the paternalistic state that corrodes self-reliance and the supporting institutions that would otherwise develop in response, and not self-reliance that somehow weakens, with the paternalistic state then arising in response. Therefore, it is inappropriate to infer on the basis of today's paternalistic institutions the degree to which people would fail to provide for their future in the absence of those institutions. Of course, there are presently substantial failures to so provide, but such failures are only a rational response to the growth of paternalistic institutions outside the family.

Social Security and the Servile State

There is no question about the substantial interest that people have in bringing some measure of security to their future. But different ways of doing this have important consequences for saving and capital formation, and hence, for future well-being. A pay-as-you-go system of Social Security reduces saving and capital formation, and thus actually acts to erode the very means by which whatever security there is can be provided. A governmentally operated funded system would fare better on this account, but there are some matters of knowledge and incentive that make the market organization of competing suppliers a superior alternative.

Different approaches to the provision of security may also have consequences that extend beyond matters of saving and capital formation. Unlike market approaches, where people acquire ownership titles to assets, people do not acquire title to assets under collective provision—especially not under the pay-as-you-go approach, but also not under a funded approach. Collective provision is proletarian in

[31]Thomas S. Szasz, *The Myth of Mental Illness* (New York: Harper and Row, 1964), p. 197. One particularly clear statement that expresses Szasz' central theme appears on p. 225: " 'Mental illnesses' thus differ fundamentally from ordinary diseases and are similar, rather, to certain moves or techniques in playing games. Suffering from hysteria is thus far from being sick and could more accurately be though of as playing a game, correctly or incorrectly, skillfully or clumsily, successfully or unsuccessfully, as the case might be."

its orientation, with security being dispensed through the taxing-and-transferring apparatus of the state and its bureaucracy. Wealth becomes in important measure a common pool to be fought over by using the instrumentalities of government, causing social life increasingly to take on the character of a clash among warring factions. Such an approach to security might be called status-extending and is an aspect of what Hilaire Belloc called the *servile state:* "That arrangement of society in which so considerable a number of the families and individuals are constrained by positive law to labor for the advantage of other families and individuals as to stamp the whole community with the mark of such labor. . . ."[32]

In contrast, what Belloc, along with G. K. Chesterton, called the distributive state, in which the ownership of property is widespread and is held severally and not collectively, seems to illustrate contract-extending approaches to security. Arrangements for market provision provide security by extending the domain over which contract operates. Such an approach is grounded in personal responsibility and the ownership of assets. Suppose characteristics such as self-reliance and personal responsibility may be nurtured or starved, depending on (among other things) whether the approach to Social Security is contract- or status-extending. To the extent that these bourgeois characteristics are essential for a liberal society, prevailing governmental systems of Social Security, by promoting proletarian characteristics, may facilitate the antiliberal movement of contemporary policy. The ownership of property and the responsibility for it may be important in supporting social relations ground in reciprocity and contract, just as the absence of such ownership and responsibility may reinforce social relations grounded in status and ordering. If so, the choice between pay-as-you-go and genuine funding may involve more than a choice about how wealthy we will be when we retire. By influencing knowledge and incentives and their political expression, such a choice might exert some influence over whether society will be more liberal or less liberal in the future. Such matters are, of course, a topic for a quite different paper than this one, but all the same such matters may be part of what is ultimately involved in a choice among alternative arrangements for providing security in a society.

[32]Hilaire Belloc, *The Servile State* (original ed., 1913; Indianapolis: Liberty Press, 1977), p. 50.

BEYOND EFFICIENCY: A COMMENT

Roger Pilon

The role of the critic is always enjoyable when it affords an opportunity to set the record straight. I am afraid, however, that no such opportunity is afforded here, for Professor Wagner has himself set the record very straight indeed. He has written an excellent paper, exploding any number of all-but-sacred myths that have surrounded the American Social Security experiment from the start. His discussion, for example, of the ultimate impossibility of efficient public funding, due to the absence of the requisite knowledge and incentive, is especially illuminating. And his arguments against even private funding, when it is made compulsory, are *nothing if not refreshing.*

Accordingly, because I find so little in this paper to criticize, I shall understand my assignment as affording an opportunity rather more to build upon Professor Wagner's arguments than to criticize them. In particular, I want to try to draw out a few of the normative features of the critique of Social Security that Professor Wagner has only touched upon, which will enable me to sharpen somewhat the distinction between these normative features and the efficiency or economic features of the critique that constitute the core of his argument.

Before I begin, however, I need to dissociate the administration I serve from anything I say here. I feel a little like David Hume in this, when he argued, before a group of his philosophical colleagues, that causality is a contingent, not a necessary feature of the world, and that just because a man falling out of a window fell downward on every previous occasion, it did not follow, with logical necessity, that he would fall downward on the next occasion. At that, one of Hume's colleagues is said to have pointed to the window, inviting the philosopher to leap, whereupon Hume replied: "But I distinguish my philosophical from my practical life." In that spirit, the

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views I express here are my own, not necessarily those of the Reagan administration or the Office of Personnel Management. Any congruence between the two should be seen, therefore, as coincidental—albeit a happy coincidence, I should add.

Turning then to Professor Wagner's discussion, he begins by distinguishing between the insurance and the welfare elements in the Social Security program, after which he explores, at considerable length, some of the central properties of collective and private alternatives for the provision of the retirement insurance component. Although he does not say so in so many words, he concludes with the disarmingly radical proposal—radical in contrast to the conventional wisdom—that we eliminate the compulsory insurance element of Social Security—whether private or public—and permit instead whatever voluntary, private arrangements might arise; for nothing but a voluntary, private arrangement would be efficient or, as he notes in his final remarks, would yield personal characteristics conducive to a liberal society. Once again, I entirely agree with Professor Wagner's conclusions and with his cogent arguments in support of them. What I want to add is simply this, that not only would a voluntary, private arrangement be more *efficient* than any alternative arrangement, but nothing but a voluntary, private arrangement would be *just*, would respect the rights of individuals to freely provide for their own security, to provide for the security of others—or, indeed, to refrain from so doing, if that is what they chose.

On two fundamentally different grounds, then, from considerations of economic efficiency as well as from a consideration of moral rights, the Social Security program is flawed. First, as Professor Wagner and many others have made clear, the system is a monumentally inefficient and, indeed, a failing program for addressing the problem of financial security in retirement. Second, even if it were the very model of economic efficiency, by virtue of its elements of forced association and transfer, the system violates fundamental rights of property, association, and contract and so is unjust.

These conclusions from ethics are rather easier to state, of course, than they are to defend. Certainly in the scope of this comment I will be able to do little more than make a few points related to their defense. In order to do even that, however, it would be well first to return to Professor Wagner's paper by way of further sharpening the distinction I have just drawn. In particular, I want to try to elucidate the following point: That while there are moral or evaluative implications of the efficiency considerations Professor Wagner focuses upon—moral implications that properly operate in the political decision-making context—these value issues should be clearly dis-

tinguished from the rights issues I have just mentioned. Rights and values are *not* the same kinds of moral notions: Most particularly, *rights are not simply values or interests that rise to a certain level of* importance, at which point they become rights. Indeed, we hold rights quite apart from whether we may or may not value the objects of those rights.[1]

Returning then to Professor Wagner's thesis, when he talks about incentives for capital dissipation, or the likely effects should government become the dominant supplier of funds in the credit markets, or the tendency of the paternal state to corrode self-reliance, we should notice precisely what it is he is doing. Strictly speaking, he is not really trying to *justify* his conclusions. Rather, he is engaged in an *explanatory* undertaking: Given certain incentives, that is, or certain changes in incentives, he is explaining and predicting what behavior or behavioral changes and what income and distributive effects we are likely to see. Not that he is necessarily evaluatively neutral about that behavior or those effects: Indeed, if put to the test, I rather think I know where he would come out in any particular case, in any particular value choice. But strictly speaking, as a positive economist, he can stay above the moral fray; he need not succumb, that is, to the Posnerian temptation to get right down there in the wealth-maximization mud, but instead can remain above it all, in a kind of austere, Stiglerian splendor, telling the legislators "Here is what you will get if you do what you propose to do; I am not here to say whether what you will get is good or bad; I am just telling you what effects your proposed legislation is likely to produce."[2]

In order to move from the explanatory to the justificatory mode, then, Professor Wagner would have to start evaluating the ends and means before him on some evaluative criterion. Again, as a careful economist, what little of this he does is done rather more by implication than in any explicit way. He observes, for example, that pay-as-you-go systems actually *reduce* security. Or he speaks of the socially wasteful effects of even compulsory *private* annuities and of the transfers such annuities would entail, leaving it to us to infer that he is not in favor of reduced security or social waste or transfers. Such inferences, however, are no part of his explanatory work as a positive economist. Indeed, there are economists who support certain measures

[1]See H. L. A. Hart, "Are There Any Natural Rights?" *Philosophical Review* 64 (April 1955): 186.

[2]See Richard Posner, "Utilitarianism, Economics, and Legal Theory," *Journal of Legal Studies* 8 (January 1979):103–40. I have criticized these views in my article "On Moral and Legal Justification," *Southwestern University Law Review* 11, no. 4 (1979): 1334–38.

precisely *because* they entail their favored sorts of transfers, notwithstanding the implications of such measures for social wealth.

Where those justificatory arguments *do* come to the fore, of course, is in the political decision-making context. Legislators in particular will make explicit their taste or distaste for such consequences as Professor Wagner has pointed to. More precisely, when legislators attempt to justify particular enactments, they will do so in one or both of two ways: They will point to the ends or consequences the legislation seeks to bring about; or they will point to the process by which the legislation was enacted. Thus, they might point to the need for universal financial security for the retired by way of justifying compulsory private annuities, valuing this end more highly than they disvalue the attendant transfers and social waste. Or they might point to the democratic process by which such a tradeoff was determined. In the first case they would justify their policy or program by reference to the *consequences* or *net good* the policy or program was expected to yield. This would be a consequentialist justification, based upon the values they placed upon the various consequences of the policy or program. In the second case, they would justify their policy or program by reference to the *process* by which it came about—presuming, by implication, the Nozickian insight that just processes yield just results.[3] This, then, would be a rights-based justification.

Now against these kinds of justificatory claims, rejoinders from considerations of economic efficiency will not avail. For the issue is not, as with the straightforward Social Security case, that the stated ends of the legislature will not be achieved by the legislative means chosen, which the economist can easily demonstrate. Rather, the stated end, universal financial security for the retired, *will* be achieved by compulsory private annuities, albeit not by the most efficient or just means. In order to achieve their objective, that is, the legislators have simply elected a less efficient and just policy than they otherwise might have done.

If we are to show, then, that compulsory private annuities are unjustified—or indeed that *any* enactment that entails forced transfers and hence takings of liberty and property are unjustified—it will not do to proceed from considerations of consequences, including economic efficiency as but one among many such consequences. For the legislature, in the case at hand, has already done its consequentialist calculation and has decided against efficiency as the dominant

[3]See Robert Nozick, *Anarchy, State, and Utopia* (New York: Basic Books, 1974), pp. 149–60.

consideration. What we need to do instead, then, is leave the consequentialist mode of justification altogether—which has been fraught with insurmountable difficulties since Bentham first set about the development of a utilitarian calculus—and turn instead to the rights-based, process mode of justification as sketched by Locke, as understood intuitively by Jefferson, and as developed more fully by Kant and, more recently, by Nozick and other contemporary philosophers.[4]

Continuing, for example, with the case before us—namely, a statute compelling private annuities—an indirect rights-based rejoinder might begin by going straight to the political jugular, to the political decision-making process itself, including the democratic decision-making process. Now before I inveigh against so hallowed an institution as democracy, let me try to avail myself of what protection I can find in the observation that I follow a long tradition here, stemming at least from Plato and Aristotle, although the arguments I will barely be able to mention are of substantially more recent vintage. There are first the arguments from decision theory that show that rarely if ever do we get majoritarian preferences from majoritarian processes.[5] So compelling are these arguments that they simply cut the factual floor out from under the democratic assumptions. But even if the majoritarian process did yield majoritarian preferences, absent some primordial unanimous consent, which has ever been a myth, much less a consent that binds heirs, that process can hardly address the fundamental question of political theory: By what right does one man have authority over another?[6] So compelling are the moral arguments from theoretical anarchism, that is, that not even the recent and brilliant work of Nozick has succeeded in overcoming them.[7] Not that I am calling for anarchism, mind you. With Hume, again, I distinguish my philosophical from my practical life—and, I might add, from my political life. But I do mean to point to the fundamental air of illegitimacy that has ever surrounded the collectivist engine, whether driven by a majoritarian or by any other preference save unanimity. And I would hope that an appreciation of that

[4]See, e.g., Alan Gewirth, *Reason and Morality* (Chicago: University of Chicago Press, 1978); Alan Donagan, *The Theory of Morality* (Chicago: University of Chicago Press, 1977); Charles Fried, *Right and Wrong* (Cambridge, Mass.: Harvard University Press, 1978).

[5]See William H. Riker, "Implications from the Disequilibrium of Majority Rule for the Study of Institutions," *American Political Science Review* 74 (1980): 432–46.

[6]See Robert Paul Wolff, *In Defense of Anarchism* (New York: Harper & Row, 1970).

[7]See Nozick, part I. I have criticized these arguments in "A Theory of Rights: Toward Limited Government" (Ph.D. diss., University of Chicago, 1979), chap. 4.

air of illegitimacy might serve as a brake upon state action—and in particular upon trying to do "good" through state action.

But what, after all, is the Social Security program if not just that—an attempt to do good through state action? Like most other legislative measures—certainly most 20th-century measures—it joins individuals, many of them unwilling participants, in the collective pursuit of some "social good." In so doing, it violates the fundamental rights of property, liberty, and association of the unwilling participants. The direct rights-based rejoinder, then, proceeds not simply from a dispositive critique of the democratic process but from the affirmative theory of individual rights. It is a long and detailed undertaking of many parts, aimed ultimately at supplying the justificatory foundations for the conclusions set forth in the Declaration of Independence and the Bill of Rights, and aimed as well at dispatching Franklin Delano Roosevelt's "second Bill of Rights"—his "security rights," so called.[8] For if the classical rights of individual liberty and private property are justified, they allow no room for these "security rights," except insofar as such rights are created through voluntary processes, which alone are consistent with rights of liberty and property. Once again, however, none of this affirmative theory can be developed here.[9]

In summary, then, Professor Wagner's paper has set forth a number of important arguments aimed at demonstrating the untenability not simply of the Social Security program but of any compulsory retirement security program. In the end, however, his arguments depend upon a certain ordering of preferences, a certain value structure, which many of us may share, but which many legislators may not. Accordingly, his arguments need to be buttressed by further arguments, taken not from the theory of value, whether economic or moral, but from the classical theory of rights. And those arguments need to be directed not to the legislature but to the courts.

[8]See Franklin Delano Roosevelt's message to Congress, January 11, 1944, and his Chicago speech, October 28, 1944, cited by Edward S. Corwin, *Liberty Against Government* (Baton Rouge, La.: Louisiana State University Press, 1948), pp. 4–5.

[9]For a fuller discussion of this theory, see my articles mentioned above as well as the following: "Ordering Rights Consistently: Or What We Do and Do Not Have Rights To," *Georgia Law Review* 13 (Summer 1979): 1171–96; "Corporations and Rights: On Treating Corporate People Justly," *Georgia Law Review* 13 (Summer 1979): 1245–1370; "On the Foundations of Justice," *Intercollegiate Review* 17 (Fall/Winter 1981): 3–14; "Capitalism and Rights: An Essay Toward Fine Tuning the Moral Foundations of the Free Society," *Journal of Business Ethics* 1 (February 1982): 29–42; "Property Rights, Takings, and a Free Society," *Harvard Journal of Law and Public Policy* 6 (Summer 1983):165–95.