PRIVATE ALTERNATIVES TO SOCIAL SECURITY: THE EXPERIENCE OF OTHER COUNTRIES

John C. Goodman

Introduction

When the Greenspan Commission on Social Security Reform took up its historic mission, the nation faced two major Social Security problems, a short-run problem and a long-run problem. The short-run problem was relatively easy to define. The Commission estimated that we would need an additional $150 billion to $200 billion over the next six years to pay for benefits that had already been promised. So in a general sense, the solution to the short-run deficit was dictated even before the Commission began its work: Somehow the government would have to raise $150 billion to $200 billion in additional taxes.

Like the short-run problem, the long-run problem of Social Security was also a financial one. But the long-run problem was much more severe. Under the "pessimistic" assumptions adopted by the Social Security Administration, we faced the strong possibility that 70 years from now between 40 and 50 percent of all taxable payroll would be needed to pay for the package of benefits that had been legislated into law.[1]

Now, extracting *half* of every payroll to support Social Security is a frightening prospect. There are two things that should make us view this projection seriously. First, the "pessimistic" assumptions used for short-run predictions in the past have tended to be much closer to reality than the "intermediate" assumptions of the Social Security Administration. Second, the "pessimistic" projection of the

---

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

The author is president of the National Center for Policy Analysis and is associate professor of economics, University of Dallas, Irving, Tex. 75061.

[1]See A. Haeworth Robertson, *The Coming Revolution in Social Security* (McLean, Va.: Security Press, 1981), p. 90.

Social Security Administration is by no means the worst thing that could happen. Who could have imagined 70 years ago that today we would have virtually eliminated polio, measles, and diphtheria—or that today at least half of all children with leukemia can be saved.

In a similar vein, what would happen if over the next 70 years a radical breakthrough occurred that drastically slowed the aging process and expanded the length of retirement, without correspondingly changing the number of years over which a person could engage in useful work? The result would probably be that in the next century, instead of having two workers for every retiree, we might have one worker supporting two retirees, or even three, four, or seven retirees. Such a development would not only be economically disastrous for the country, it would threaten the very political and social fabric of our nation.

I have always considered it ironic that the possibility of finding a cure for cancer and many other diseases—developments that would prevent death and prolong life—are cast in a negative light for the purposes of social welfare planning. Developments that most of us would consider optimistic, the Social Security Administration regards as pessimistic.

The long-run problem of Social Security, then, is much more than a matter of money. The real long-run problem is that we are placing future generations at great risk. It is much more than an economic problem. It is a moral problem. And it revolves around the question of whether we have the right to impose this risk on future generations—to mortgage the future of our children in this way.

The term "future generations" is abstract, but we must realize that children entering the first grade today will be alive and drawing Social Security 70 years from now. So when we talk about how the Social Security Administration will affect "future generations," we are talking about real people—the sons and daughters and grandchildren of everyone who is alive today.

Because the long-run situation is so serious, it is extremely important that in dealing with the short-run deficit we adopt solutions that deal effectively with the long-run problem. The argument of this paper is that the reforms adopted by the Greenspan Commission will aggravate the long-run problem, making it worse than it otherwise would have been.

Recent Reforms

To repeat, the basic problem faced by the Greenspan Commission and by Congress in the short run was that of raising $150 billion to

$200 billion in additional taxes. The Commission approached this task from two angles: first, by increasing the payroll tax; second, by increasing the number of people who pay it.

Prior to the 1983 reforms, about 5 percent of the labor force worked for an employer who was not legally covered by Social Security. Another 20 percent worked for an employer who had the option of either remaining in the Social Security system or opting out. These employers were primarily nonprofit institutions, and state and local governments. Among the latter group, about 5 percent of the labor force worked for an employer who had exercised the option of staying out. In addition, a growing number of eligible employers were exercising their right to opt out of the system. Between 1980 and 1982, for example, there were more than 1,150 applications to opt out submitted to the Social Security Administration; 412 were from state and local governments.

Thus, in the United States, we faced the real possibility that as many as 25 percent of all workers were going to opt out of Social Security. On the negative side, such opting out does create a short-run problem in the sense that we would have 25 percent fewer taxpayers. But on the positive side, we would ultimately have 25 percent fewer beneficiaries, which would have mitigated the long-run problem.

The solutions proposed by the Greenspan Commission, and adopted by Congress, are designed to force these people back into the system. At the end of this year, all nonprofit institutions will be forced to become a part of the Social Security system. Furthermore, the reforms will put a halt to the exodus of state and local governments from the system and will require all new federal employees to join the system. While it is true that these reforms will give us more tax dollars now, it is also true that they will worsen the problem in the future, when there will be a correspondingly higher number of retirees who will be drawing benefits. Seventy years from now, the amount of money needed to pay benefits will be about 25 percent higher because of the 1983 reform legislation.

It is important to note that the problem we face in the United States is no different from the problem facing every other developed country. The long-term problem of solvency in Social Security stems from an inherent flaw in any pay-as-you-go pension system. This system is characteristic of virtually every developed nation in the world, and the only way to eliminate or reduce the problem is to eliminate the pay-as-you-go feature, or reduce it as much as possible.

There are governments in the world today that have taken major steps in this direction. Britain is one; Chile is another. Both of these

nations have acted responsibly and rationally to assure that current retirees will continue to receive their full benefits; but at the same time they have greatly reduced the long-term liability of their Social Security systems. In both cases, these countries took steps in the exact opposite direction from those recently taken by the U.S. Congress. They acted to solve their long-term problem *not* by forcing more workers into the system, but by going to great lengths to encourage workers to opt out.

Now if it were a law of social science that human societies inevitably construct Social Security systems that by their very nature are doomed to failure, then it would be futile for us to worry about the future. It would be a foregone conclusion, not subject to change. But such a development is not inevitable. Indeed, the examples of Britain and Chile provide evidence that policy makers can act responsibly to prevent—or at least greatly diminish—the kind of crisis we face today in the United States.

Contracting Out of Social Security in Great Britain

Britain has had a system of contracting out of Social Security (on and off) since 1960.[2] In many ways, the issue of contracting out has had a history similar to that of the issue of privatizing the steel industry. The Conservative Party favored it. The Labour Party opposed it. And when each party got into office, it put its own program into effect and reversed the policies of the previous government. In 1978, however, Britain launched the most comprehensive contracting-out scheme to date, with the endorsement of both the Conservative and Labour parties. As such it represented a political compromise.

Essentially, Britain has two types of Social Security benefit schemes. One requires mandatory participation, the other is voluntary. The first tier, the mandatory scheme, pays a benefit that is like a minimum income. All workers must pay in, and above a certain earnings level, they receive the same benefits regardless of their earnings and regardless of the amount of taxes they contributed.

The second-tier pension scheme, however, is based on earnings. The more you earn, the greater your pension. Thus, the second tier is comparable to a private pension plan as we know it. In addition, and unlike the first-tier scheme, the second-tier pension is not mandatory. Private companies are granted the option of contracting their

[2]For a more complete description of the British Social Security system, see John Goodman, *Social Security in the United Kingdom: Contracting Out of the System* (Washington, D.C.: American Enterprise Institute, 1981). See also idem, "Lessons from Abroad," *Rebuilding Social Security*, vol. 18 (1982), pp. 23–31.

employees out of the second-tier benefit program and into a private pension plan. They are allowed to do so only if they provide their workers with a plan that provides benefits as good as or better than the workers would have received had they remained in the state system.

An example of contracting out is shown in table 1. Taxes and benefits are illustrated for a worker who earned the average wage in April of 1978, when the new system was put into effect. If pounds are converted to dollars using the exchange rate of one pound for two dollars, then a worker who has contracted out of the second-tier

TABLE 1

THE CONSEQUENCE OF CONTRACTING OUT FOR A WORKER EARNING THE AVERAGE WAGE IN APRIL 1978

	Full Participation	Contracting Out
Annual income	£4,160.00	£4,160.00
Payroll tax on the first £910	168.35	168.35
Payroll tax on additional income	601.25	373.75
Total payroll tax	£769.60	£542.10
Annual tax reduction for contracting out		£227.50
Annual pension from the state for one year of employment (in 1978 values)		
Basic component	£910.00	£910.00
Additional component [.0125 × (4160 − 910)]	£40.63	-0-
Annual pension from the state for 20 years of employment (in 1978 values)		
Basic component	£910.00	£910.00
Additional component [.25 × (4160 − 910)]	£812.50	-0-

Each year the contracted-out worker gets a tax reduction of £227.50 in return for forgoing the right to draw an annual pension from the government equal to £40.63 per year.

pension scheme pays about $455 less in taxes each year. In return for this tax reduction, he forgoes an annual pension equal to $81.26. The amount of tax reduction is chosen so that on the average, workers will find it to their financial advantage to contract out of the system.

April 1983 marked the five-year anniversary of the two-tier system, and to date it has been highly successful. Since 1978, more than 45 percent of all British workers have contracted out of the second-tier pension scheme. Moreover, by allowing the option of contracting out, the British government has effectively cut its second-tier pension liability in half. Overall, I estimate the government has reduced its entire Social Security liability by more than 30 percent by adopting the contracting-out system.

It is important to recognize what the British system of contracting out does and does not accomplish. In particular, it does not solve Britain's current short-term Social Security problem. There are a number of pensions-in-payment, and government must raise the revenue to pay for them. So in the short run, the government must have almost as much tax money today as it would have had without the contracting-out scheme. Nevertheless, over the long term, pension payments will be significantly reduced.

Several additional points about the British system should be emphasized. First of all, the choice to contract out is not an individual worker's choice. It is an option granted only to employers. Employers contract their workers out of the second-tier pension system by providing them with an adequate pension. Of course, it is expected that the employers will exercise this option only after consulting with their employees.

Second, private employers cannot contract out some workers and leave others in. That is, they cannot simply remove the workers who are most favorably affected by the new scheme while leaving all other workers in the state pension system.

Third, the same tax reduction is given to all workers regardless of age and income level. Table 2 illustrates the importance of this condition. The table shows the present value of full participation in the British Social Security system for workers at different age and income levels. For example, a single, male worker who is 20 years old and earning the maximum taxable income of £6,240 per year has a present value in Social Security of −£22,423. Simply put, his stake in the system is negative. On the other hand, a 50-year-old worker who is fully participating in the system and who is making a minimum income of £910 per year has a present value in Social Security equal to about £5,618. Thus, as the table illustrates, British workers at

TABLE 2

NET SOCIAL SECURITY WEALTH (IN POUNDS) FOR FULLY PARTICIPATING MALES, BY AGE AND WAGE LEVEL

Weekly	Age			
Wage (£)	20	30	40	50
17.5	−8,219	−68	2,330	5,618
20	−9,722	−512	1,534	3,972
30	−15,738	−2,284	587	3,577
40	−19,512	−4,057	−360	3,183
50	−20,680	−5,829	−1,307	2,789
60	−21,297	−7,602	−2,254	2,395
70	−21,701	−9,374	−3,201	2,001
80	−21,969	−11,147	−4,148	1,607
90	−22,146	−12,919	−5,094	1,213
100	−22,281	−14,347	−6,041	819
110	−22,352	−14,828	−6,988	425
120	−22,423	−14,987	−7,752	12

Note: Figures are for a real rate of growth of income of 1.75 percent and a real interest rate of 3 percent.

different age and income levels are affected in different ways by the Social Security system.[3]

All workers contract out on the same terms, however. In 1978, workers who were fully participating in Social Security paid a payroll tax of 18.5 percent. Workers who had contracted out paid a payroll tax of 11.5 percent, so the tax reduction for contracting out was 7 percentage points. Elderly workers have less to gain by contracting out, for two reasons. First, they have a longer life expectancy and therefore can expect to draw more monthly benefit checks than younger workers. In addition, they have fewer taxpaying years left. So contracting out is less appealing to an older worker than it is to a younger worker.

It turns out that the amount of tax reduction necessary to encourage a 20-year-old male worker to voluntarily contract out of the system would be only about 4 percentage points of payroll tax. On the other hand, to get a 50-year-old worker to voluntarily opt out of the system

[3]Similar differences exist in the United States. See Martin Feldstein and Anthony Pellechio, "Social Security Wealth: The Impact of Alternative Inflation Adjustments," in Colin Campbell, ed., *Financing Social Security* (Washington, D.C.: American Enterprise Institute, 1979), pp. 91–117; and Anthony Pellechio and Gordon Goodfellow, "Individual Gains and Losses from Social Security before and after the 1983 Amendments," *Cato Journal* 3 (Fall 1983): 417–42.

would require a difference of about 8.6 percentage points. Because the terms of contracting out treat all workers the same, and give all workers only a 7-percentage-point tax reduction, it is necessary to do contracting out on a group basis so that the companies that choose this option will have some young workers, some old workers, some male workers, and some female workers.

One way to understand the British system is to compare it with something that we have allowed to happen in the United States: the practice of allowing nonprofit corporations to opt out of the system. Baylor University Medical Center in Dallas, for example, is a huge medical complex that employs about 6,000 people. In the fall of 1982, they opted out of the Social Security system. The retirement plan that Baylor adopted was an "integrated plan," which means that it is integrated with the current Social Security system.

In essence, what the Baylor plan does is to establish for each worker a target level of retirement income, typically about 60 or 65 percent of preretirement income. The private plan pays survival and disability benefits not paid by the Social Security system. If the employee is entitled to Medicare benefits, then he receives them. If not, then the Baylor plan pays the fee necessary to enroll the employee in the Medicare program. Baylor University Medical Center calculated that in order to fund its private plan, it needed a total payroll tax of only 8.4 percent. Compare that to the 13.4 percent of payroll tax imposed by the Social Security system. Baylor calculated that over the next 10 years, it and its employees would save $92 million by opting out of Social Security.

There are two basic differences between what the Baylor Medical Center was allowed to do and what happens in Britain. First, in Britain you can opt out of only the retirement part of Social Security. You cannot opt out of other social insurance programs, such as National Health Insurance. This difference, however, is a minor one. The major difference is that under the U.S. system we have allowed an entity like Baylor Medical Center to retain $92 million as a result of opting out. In Britain the tax reduction given to companies that contract workers out is geared to be just enough to encourage opting out, but no more than that. So, for example, if we were applying the British example to Baylor Medical Center, we would not want to give away $92 million. Instead of allowing Baylor Medical Center to pay no payroll taxes as a result of opting out, we might set its payroll tax at about 5 percent. In this way, Baylor employees would still be paying something into the Social Security system, but their tax reduction would still be sufficient to encourage opting out.

I believe the Greenspan Commission should have proposed a plan similar to Great Britain's. If it had done so, it would have proposed continuing to encourage nonprofit institutions and state and local governments to opt out of the system, but it would have imposed an additional tax on them. In this way, the Social Security system would have received additional revenues in the short run, but would not have taken on the additional liability of having to pay more pensions to these workers in the long run.

Opting Out of Social Security in Chile

Chile adopted a system of opting out of Social Security in May of 1981. Unlike Britain, however, the Chilean scheme is an individual choice, not a company choice. Individuals are allowed to opt out of Social Security by putting at least 10 percent of their income into the Chilean equivalent of an Individual Retirement Account. The IRA is managed by private companies, such as insurance companies, banks, or other thrift institutions. As in the United States, there is competition among these institutions for the IRAs. At the same time, there are some restrictions on what kinds of investments the institutions can make with their clients' money.

The payroll-tax reduction for opting out of Social Security in Chile is 10 percentage points of income. If you remain in the system, you pay a payroll tax of 27 percent; if you opt out, the tax is reduced to 17 percent. So the 10 percent income saved by "opting out" is theoretically the 10 percent transferred into an IRA. Finally, all new workers in Chile are kept out of the state-run Social Security system and are required to open up their own IRAs.

For Chilean workers who had been under the state system in the past and choose to opt out, the government gives them nontransferable bonds to cover their past contributions to the system. These bonds can be redeemed when the worker retires. At the retirement age, which is 65 for men and 60 for women, the worker may use the funds in one of several ways. For example, the worker can take a series of programed withdrawals over time from the account, or can purchase an annuity with funds from the account. In the former instance, any money not spent by the retiree will belong to his or her estate. The only requirement is that a worker must leave enough in his account to guarantee him the minimum pension guaranteed by the government, which in 1981 was about $100 per month.

The system has been enormously successful. Between May and December of 1981, almost 50 percent of all Chilean workers had exercised the option to be out of the state-run system.

Principles of Contracting Out

If we are to adopt a system of allowing either contracting out of Social Security by companies or of opting out of Social Security on an individual basis, there are two political realities that cannot be ignored. First and foremost is that current retirees must be paid the benefits they have been promised.

Benefits received by Social Security retirees are essentially dictated by a delicate political equilibrium. There is a natural political tension between the young and the old because we are in a pay-as-you-go system, and taxes paid in by the young are paid out in the form of benefits to the old. In order for the retirees to have greater benefits, higher taxes must be placed on young workers. Conversely, any proposal that drastically reduces promised benefits to current retirees is likely to be rejected.

The second political reality is that the choice to contract or to opt out must be voluntary. It must be perceived that workers are given a choice. If you opt out of the system, you get a tax reduction. In return for that tax reduction, you forgo certain claims against the Social Security system. On the other hand, if you want to stay in, you pay a higher payroll tax. Workers must be given the choice of staying in the system, but they must understand that their choice means that payroll taxes are going to be higher than they are today. These two political realities dictate the structure of contracting out of the scheme.

And finally, any new system must have two structural components: First, since benefit payments to current retirees cannot be changed, we must collect enough in taxes now to pay those obligations. In other words, the total amount of payroll taxes collected under a new system must equal what it was under the old system in the short run. Second, there must be a differential payroll tax. Those who remain in the system must pay higher payroll taxes than those who opt out. After all, it is the differential payroll tax that gives people the incentive to opt out.

It is worth noting that the differential payroll tax has to be larger in the short run than in the long run. When Britain adopted its system in 1978, it needed a payroll-tax reduction of approximately 7 percentage points to encourage companies to opt out of the system. Five years later, in April of this year, Britain was able to reduce that payroll-tax differential to 6.5 percent. In future years they will be able to reduce it even further. And, as I pointed out earlier, for each new generation of workers you need only about a 4-percentage-point reduction in the payroll tax to induce workers to choose the contracting-out alternative.

Conclusion

To my knowledge, the Greenspan Commission on Social Security Reform did not hear testimony from a single individual describing how contracting out or opting out works in other countries. In fact, this viable alternative to the present system was not even marginally considered.

Yet, contracting or opting out of Social Security is clearly politically practical. The example set by Great Britain, a major industrialized Western nation and a democracy somewhat similar to ours, proves it. Even though Britain is more socialistic than the United States, it adopted radical reforms to reduce its long-run Social Security problems.

Furthermore, Britain's two-tier scheme faced no major opposition and was either endorsed or at least not opposed by the country's major trade unions. Their members had the most to gain by the new system, since it was these workers who (by and large) had the best private pension plans already in existence.

Contracting out or opting out of Social Security also makes a great deal of economic sense. Taxes paid into a pay-as-you-go Social Security scheme primarily finance current consumption. By contrast, contributions made to private pension plans provide additional funds for the private capital market. These additional funds allow increased private investment and stimulate economic growth. We owe it to ourselves to do what the Greenspan Commission did not do, and that is to take a closer look at this alternative.

BREAKING THE POLITICAL BARRIERS TO PRIVATIZATION

Don Bellante

A point that seems central to almost any discussion of policy options is that what appears to be an economic problem is often much more of a political problem. We have seen an interest develop in the privatization of Social Security that would have been difficult to envision a decade ago. Even if we could take for granted a consensus opinion to the effect that Social Security should have been privately provided from its very beginning, we would expect the political difficulties that would stand in the way of privatization to be formidable.

The genuinely political problem begins with the transitional costs associated with privatizing the system. There is an implicit understanding that privatization is impossible without abandonment of the pay-as-you-go feature of the system, so the two issues are not distinct. Every responsible proposal for conversion to a fully funded system has addressed itself to the transitional problem, the nature of which makes the political barriers to privatization seem immense. Left to my own intuition, I would judge those barriers to be insurmountable, perhaps not even worth a try. But economists are not particularly astute at determining what is or is not politically feasible. How many economists four years ago would have thought it feasible that Congress would index taxes? Hence, to proponents of privatization of Social Security, the fact that Great Britain and Chile have moved in the direction of privatization must be very encouraging. John Goodman has made us aware of some of the details of these moves. He has shown that the acceptance of "opting out" in these two countries demonstrates its political feasibility as far as those two nations are concerned. What should be of greatest concern to advocates of privatization in the United States is whether or not there are lessons to be learned from the British and Chilean experiences, and whether

Cato Journal, vol. 3, no. 2 (Fall 1983). Copyright © Cato Institute. All rights reserved.
The author is professor of economics, Auburn University, Auburn, Ala. 36849.

or not those lessons can be utilized to advantage in an American effort to privatize.

The Chilean experiment, in its significant features, bears a strong resemblance to Milton Friedman's proposal for reform of the U.S. Social Security system as explained by Ferrara, with the important exception that workers in Chile do have the option of remaining in the Social Security system.[1] It appears that Friedman's influence on economic policy in Chile has been even greater than many of us had realized. A more fundamental distinction between the Chilean program and the Friedman proposal is that in the former a payroll tax continues to be imposed on those workers who opt out. Professor Goodman seems to be implicitly suggesting that workers might be inclined toward indifference between staying in and opting out because the total cost of provision for retirement remains the same either way. Whether or not Professor Goodman intended such an implication, I do think that it is a more or less valid conclusion, but only because of the circumstances that are peculiar to Chile.

Normally, we should expect both current cost differentials and differentials in expected retirement benefits to determine the worker's choice on opting out. But the Chilean case is not normal. The average Chilean faces what must surely be an imponderable problem in trying to guess the form of government he will be living under in the distant future. It will be even more difficult for him to determine the probability that the benefits that will result from remaining within the state system will even remotely resemble their present structure and level. On the other hand, the future state of private property rights under whatever form of government prevails is at least as radically uncertain. With such radical uncertainty, it would not be surprising that Chilean workers would give the appearance of basing their decision on the current cost differential. Since this differential is zero, such workers might just as well decide by the toss of a coin—a decision rule that would yield the same proportion opting out as we now observe doing so.

In short, we do not know whether the rate at which Chilean workers have chosen to opt out provides any indication of what American workers would do. Similarly, the Chilean experience tells us little if anything about the political feasibility of attempts at establishing the option of contracting out in the United States. The simple fact is that Chile is not a democracy, and thus the political constraints are of a wholly different nature.

[1]The Friedman proposal is discussed in Peter J. Ferrara, *Social Security: The Inherent Contradiction* (San Francisco: Cato Institute, 1980), pp. 348–50.

The case of Great Britain leads to just the opposite conclusion: There are probably many lessons to be learned from the British experience. In the British plan workers whose employers have opted out continue to pay a tax, lower than the tax paid by workers remaining wholly in the system. However, workers whose employers have opted out retain a claim to the mandatory component of the Social Security program. While purists may take a dim view of such political compromises, it is probably just the degree of compromise that made opting out a political possibility in a democratic society similar to ours. In effect, workers were allowed to hedge a bet, and U.S. proponents of opting out should take note. If British workers feel more secure with partial opting out as time goes by, then it will gradually become politically more feasible to move further in the direction of complete opting out. Further, the requirement that employers opting out provide a retirement benefit comparable to what workers could receive from the optional part of Social Security goes as far as is possible in the direction of guaranteeing that workers who opt out will be no worse off at retirement. This feature probably made opting out far more politically feasible than would have been the case under an alternative requirement, i.e., that the contribution be a defined amount with the retirement benefit left uncertain. As appears to be the case from the description provided by Professor Goodman, the bearing of risk is undertaken by employers, or their contractors, who are in a position to better deal with the risks involved.[2]

Professor Goodman has provided us with reasonably complete information about the financial impact on employees of opting out, but we do not have similar information about the impact on employers. Yet we do know that it is employers who have the option, and that employers representing 45 percent of the work force have opted out. For these employers at least, opting out obviously must be financially attractive. But what makes it attractive? We should like to know, for example, whether employers are required to fully fund their obligations, before we reach any conclusions about the desirability of imitating the British system.

There are other important questions for which the information furnished does not provide a basis for formulating answers: How does the existing structure of taxes and retirement benefits, with its provision for opting out, differ from the structure that preceded it?

[2]The shifting of risk bearing between firms and workers is at the base of many of the recent developments in macroeconomic theory. Cf. Costas Azariadis, "Implicit Contracts and Underemployment Equilibria," *Journal of Political Economy* 83 (November/December 1975): 1183–1202.

The answer to this question would be of use in determining what factors made the reform politically attractive. Did the reform also accomplish the task of changing from an actuarially unsound to a sound program? If the preceding system was more nearly sound, then the attainment of political acceptability for the contracting-out system would be less of a problem.

The problem facing the U.S. system is particularly acute. The actuarial weakness of the existing structure of payroll taxes and benefit obligations makes political acceptance of privatization more difficult, not less difficult as is commonly believed. Among U.S. workers old enough to place more emphasis on the structure of benefits than on the burden of payroll taxes, the acceptance of a private system would be far more likely if they compared it with the benefits that would accrue *on an actuarially sound basis* from the present payroll-tax structure, instead of comparing it with the present, *actuarially unsound* structure of benefits. It is an undeniable fact that the present structure of benefits is not sustainable under the present structure of taxes. Moreover, benefits are probably well in excess of what would result from a fully funded system. This observation highlights the most fundamental aspect of the problem.

Critics of the existing U.S. system emphasize that it mixes a welfare function with an insurance function. What should be emphasized is that 100 percent of the existing system is a welfare program that redistributes income from those who are working to those who are retired. Current retirees are receiving large net gains; and those close to retirement expect a net benefit from the system, while younger workers do not. It is the fact that so many workers currently expect to be net gainers that explains much of the opposition to privatization. Only when most workers are disposed to see the chain-letter effect of the pay-as-you-go system as harmful to their long-run interests will political resistance to privatization be reduced to manageable proportions.

One of the most intriguing facts related to the British provision for opting out is that this reform was instituted under a Labour government. As Professor Goodman points out, unions either supported or ignored the move toward allowing workers to opt out. He also points out that in the past, the Labour party opposed the permitting of opting out. Why did the labor movement of Great Britain act as it did? Why the change of heart? Something about the current program must have been more attractive to the unions than was true of prior opting-out programs, and we should want to know precisely what has "sweetened the deal." We sometimes automatically tend to think of unions, particularly British unions, as favoring anything that strengthens the

hold of government over society's resources. But this knee-jerk reaction ignores the likelihood that unions will prefer union control of resources to government control. Recognition of this point suggests that the opting-out program of Great Britain presents increased opportunities for such union control.

Unions in Great Britain have a great deal more influence over the investment of funds than unions in the United States. And it is surely no coincidence that the current program was being promoted in Parliament at about the same time that the Labour government's minister of state for Social Security was proposing a bill that would legally require at least 50 percent representation by trade unions on the controlling bodies of all occupational pension programs.[3] Although the provision for opting out did get through, any chances of passing the minister's bill expired when Labour's control of Parliament expired. But this knowledge of the political horizon as it appeared in the late 1970s may go a long way toward explaining the stance of the unions and their political party. One conclusion to be drawn is that political acceptance of privatization in the United States will require that organized labor see gains from privatization. The provision of some union role in the management of pension plans of organized firms is the most obvious such gain, although an extreme move such as was attempted in Great Britain would probably not be necessary.

The provision of a union role in the management of pension funds may be too high a price to pay for privatization. For the last several years the American labor movement has heavily promoted legislation favoring union control of pension funds, and the advocates of union control have stated quite emphatically that their motives go well beyond the assurance of safety of and return on investments. The movement has been viewed with alarm in some quarters, but I have argued elsewhere that a union role in pension-fund management, even if it operates perversely, will have its strongest effects on union members.[4] In other words, any significant negative effects are likely to be internalized. Union members may wish to take the matter into consideration, but the rest of society probably need not do so. In any event, the extent of unionization of the U.S. labor force is less than half of what it is in Great Britain, and so union support, or nonsupport, of privatization is not likely to be as consequential in the United States as it must have been in Great Britain.

[3]Paul Johnson, "Unions, Pensions, and Financial Responsibility: The British Experience," *Journal of Labor Research* 2 (Fall 1981): 289–98.

[4]Don Bellante, "Union Divergent Investing of Pensions: Comment," *Journal of Labor Research* 2 (Fall 1981): 209–13.

Overall, I am compelled to agree with all of Professor Goodman's conclusions. If privatization is politically feasible in Great Britain, it is politically feasible here. The failure of the Greenspan Commission to give even the slightest consideration to any degree of privatization is inexcusable. The advocates of privatization thus have a lot of work to do, but the knowledge of what Great Britain has accomplished should encourage them in their efforts.