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Political Risk and Social Security Reform

By Hugh Heclo

Summary

Retirement programs are long-term commitments. They will always depend on America's political process. Every reform depends on government keeping its promises and maintaining the integrity of the system over the long haul. "Political risks" are different from uncertainty about what the future holds. Uncertainties — such as an unexpected change in economic or demographic conditions — can beset any policy. Political riskiness, in contrast, is inherent in the policy itself. It refers to a given plan's vulnerability to being destabilized as time passes, rendering it unsustainable in its original purpose and promised operations. We are more likely to recognize the political risks in the system we have than to predict the new political risks in a significantly restructured system.

Wide-ranging as they are, all of the major Social Security proposals being debated today seek to reform, not abolish, government's role in retirement policy. Amid the swirl of complex details, it is important to recognize this common ground because it reveals a *de facto* agreement most Americans share about the basic purpose of government retirement policy.

The Inevitability of Government

The term "privatization" is now widely used to characterize prominent Social Security reform proposals. No major initiatives, however, advocate a total government withdrawal from the problem of financial insecurity in old age; none would rely solely on do-it-yourself, voluntary provisions within a world of strictly "private sector" retirement arrangements.

This is true because there is no government-less private sector in sight to withdraw to. Voluntary, market-based, "private" retirement plans have been created and spread within a federal policy framework of tax incentives and federal regulations creating nationally uniform rules (e.g. fiduciary responsibilities, diversification requirements and so on).[1] Moreover, employer- sponsored pension plans are designed by taking account of the existence of Social Security.[2] Thus any dismantling of the current Social Security program will itself affect virtually all operations and expectations within this system of voluntary retirement plans. Likewise, even the most "private" individual investments for retirement depend on a framework of government laws and regulations for their protection in orderly markets. In one form or another, national policy — which is to say, government — is an inescapable reality of our complex modern society.

Achieving the Purpose: Retirement Security

Underlying the Social Security reform debate is a general consensus that the purpose of public policy should be to promote financial security in old age

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for all Americans. Of course there are other subordinate goals, such as redistributing resources efficiently, encouraging national savings, and so on. But the existence of sub-goals should not cause us to lose sight of the main objective.

Fundamental issues of purpose are at stake in the Social Security debate because any given policy reform may over time change the meaning of financial security in old age as well as redefine who has a reasonable assurance of such security. In other words, change in "mere" means can subtly but decisively alter policy ends as time goes on.

Why has there come to be a compulsory government role in retirement policy?[3] First, left to their own devices, people are often shortsighted about their future; by the time they realize they should have been setting aside more to provide for adequate consumption in retirement, it is too late to correct their errors. Second and relatedly, without government compulsion for all, prudent savers are vulnerable to having to support those who are imprudent. Third, there are unknowns — such as unanticipated inflation and one's own lifespan — that individuals find it difficult to insure against. Even the prudent may outlive their savings. Fourth, with the growth of modern industrial life, families have found it necessary (or highly advantageous) to have government spread across the entire society the burden of supporting aging parents that otherwise would have to occur within the family or other charitable relationships. Fifth, for large portions of the population, employers have not been able to provide for old-age pensions.[4]

Thus government-sponsored pension policy exists, first and foremost, for the purpose of making old-age income more secure for more people than would be the case if one relied only on individual decisions and market outcomes.

Social Values Are At Stake

The current reform debate is grounded in what are typically half-articulated theories and assumptions about American politics. For example, the strictly economic advantages claimed for "privatizing" Social Security can also be achieved by modifying the existing system to provide for higher rates of return on collectively held funds and by requiring more accumulation in those funds to increase national savings.[5] The different positions of advocates for individual or collective savings depend heavily on questions of values and political feasibility, not of economics.

Choosing among pension reform alternatives is not simply a matter of individuals' dollar and cents calculations. Fundamentally, the reform debate is about our society's values, people's rights and responsibilities towards each other, and what constitutes a "good society." All pension plans involve long-term risks that cannot possibly be avoided. How should those risks be shared? What should we want American society to be like?

Although specific reform proposals are embedded in deeper normative commitments, these values are rarely explicitly spelled out and argued before the public. This values dimension is especially easy to dismiss today, when political rhetoric focuses on the economic bottom line. Nevertheless, the competing visions of society embedded in the reform alternatives deserve closer scrutiny.

Two principles: individual freedom of choice, on the one hand, and shared security, on the other, are the dominant normative perspectives undergirding the Social Security reform debate. The first perspective places the highest priority on individual choice and control over one's own personal affairs. The second gives priority to securing a common social protection against the vicissitudes of life. The first normative position celebrates a free society of aggregated individuals looking out for themselves; the second celebrates a society of one people organizing mutual social protection for each other.

Since the values of both personal freedom and shared security are highly prized in American culture, advocates on each side often try to steal each others' arguments. Pro-liberty advocates may point out that security is enhanced by ownership and management of one's own assets, thereby avoiding dependence on political third-parties. Pro-security advocates can respond that freedom is enhanced by avoiding a go-it-alone approach in favor of collective arrangements that limit people's exposure to economic uncertainties and dependence on charity. Despite such acknowledgments of each other's attractiveness, individual choice and collective security remain in tension with each other.

No reform proposals being seriously debated today lie at either of these two polar extremes. All are hybrid middle-range positions trying to combine desires for both individual choice and collective social protection. This is as it should be in a democracy where people cherish two opposing but unrelinquishable values. The purpose in contrasting the two core values is to recognize that, though hybrids, the various reform options do point in one or the other of these two directions. A fundamental normative choice is at issue.

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Social Security: Mutual Protection. If Americans decide to maintain some modestly revised version of the existing Social Security system, they are in effect asserting a normative emphasis on social protection through mutual provision, a norm of social solidarity. Risks of financial insecurity in old age are pooled in one national program where people stand together by paying in earmarked taxes and receiving back standardized benefits.[6] Maintaining some version of the status quo would mean that at the center of retirement policy would be a commonly shared pension program that seeks to provide a basic retirement income for all Americans. This common security takes the form of a given array of retirement benefits, earned through a work history (not a direct return on one's own contributions) and paid however long one lives (with adjustments for inflation). Within that common coverage, each person can obtain added coverage, such as voluntary employment-based plans, IRA's, and 401(k) plans that each worker owns individually (again, aided by a regime of supportive government policy and regulations). The essence of the Social Security program itself, however, is the priority of a common social bond with a common security package for all citizens. Money's worth calculations are not decisive because they ignore the system's social solidarity mission. Thus the existing Social Security program has sought to promote what proponents regard as a fairer society than would otherwise exist.[7] Behind all the details is the moral contention that the better off should help the worst off — in this case, helping with financial security in old age among people socially bonded as equal citizens, not givers and recipients of charity.

Personal Accounts: Individual Choice. If one decides to reform Social Security by replacing all or most of the current system with some version of personal savings accounts, the main emphasis of retirement policy would be reversed. Privatization would put individually-owned and managed accounts at the center of retirement policy, accompanied by more residual social protections. Privatization alternatives would not abandon the aged who do not save enough or invest wisely to the sole support of family and friends; minimum government pensions and a means-tested welfare program would no doubt remain. But the emphasis would be on individualized security and choice rather than on the shared security of a predefined benefit. The emphasis would shift from the "one net" security of the current social insurance approach to a more individualized system, with each person much more the weaver of his or her own safety-net. Below that would lie the public provision of means-tested transfers, which opponents of this approach regard as stigmatizing charity and proponents regard as a more efficient use of resources. Be that as it may, the essence of the individualized accounts approach is the priority of individuals freely obtaining their own returns for retirement income. The prospects for great variability in those results is judged acceptable for the sake of the larger cause of creating a better society, characterized by individually responsible free choices.

Social Security reform asks Americans to consider this choice of a more individualistic or solidaristic vision of their evolving society. Experts have no special authority for telling other people what that choice should be.

Political Risks are Inescapable

Since government is inevitable, retirement policy will always depend on America's political process. Every possible reform option depends on government keeping its promises and maintaining the integrity of the retirement system over the long-haul.

The term "political risk" means a given plan's vulnerability to being destabilized as time passes, unexpectedly rendering the plan's original design unsustainable in its promised operations and purpose. Such riskiness is not the same as uncertainties about the future in general. Uncertainties — for example, an unexpected change in economic or demographic trends — can beset any policy. The forces of "political" riskiness have to do with pressures that are fashioned and put into play by a particular policy approach. Rather than like trying to predict the weather, assessing political risk is like evaluating the structure of a vessel and its capacities not only to stay afloat but to maintain its course amid inevitable but unpredictable storms.

The different approaches to retirement policy cannot rule out future political conflicts; rather, they shape what the conflicts will be about.[8] To repeat, no reform can extract government retirement policy from permanent dependence on our much maligned political process and the politics of promise-keeping over the long-haul.

Political Stability is Essential

Retirement plans — whether operated by government, employers, or individuals alone — are long-term commitments. Their long-term stability and predictability cannot be achieved in individuals' lives if public policy is vulnerable to short-term pressures and veers off path. Experts may be able to design technically correct plans. The more important concern is what happens over time when a plan meets politics. To achieve its goal, retirement policy must engender a politically stable equilibrium.

Since there is actual experience with the Social Security program, we are more likely to recognize the political risks associated with existing policy than we are to predict the new political risks arising from a more individualized system. The political risks of the current system have to do with whether the public will tolerate the benefit and tax changes necessary to restore long-term solvency to Social Security, and whether their support and confidence in the form Social Security exists in today can be maintained.

With a more individualized system, there are two forces that put it at risk of instability, and which reveal how a change in means can lead to a change in the purpose for which the policy was originally designed.

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First, there is a risk that short-term political responsiveness to constituents' demands for access to their investment accounts could easily turn long-term retirement policy into a shambles. For example, the very advantage claimed for the new system — namely, the political attraction of selling forced savings with the idea that "it's your own money" — will make it more difficult in the long run to sustain such nest eggs for retirement. Under a privatized system, elected politicians will have to resist voters, who having been told it is "their money" that the government has compelled them to save in these accounts, must also be told they cannot get at it when they and their dependents need it.

Second, there is concern that, as time passes, the operational politics of such a system will undermine any sense that Americans share a commitment to adequate retirement pensions for all workers.

Individuation is the very essence of privatized accounts. At the outset, reforms might contain both privatized accounts and some version of the current Social Security benefits. However, a two-tier pension system can easily evolve into a division of political constituencies between the weak and the strong. Low-earning, irregularly employed workers will not do as well as others in accumulating personal investment accounts. Neither are they likely to have the investment savvy of more privileged portions of the population. At the same time, the economically better-off will have a vested interest, and more political clout, to push for further improvements in the privatized sphere of federal retirement policy. The constituency more dependent on the residual pension is unlikely to have the power to keep up with this quiet revolt from above. The real political risk is not class warfare but a soft landing into growing inequality. In sum, the long-term political risk of privatized accounts is that the nation will gradually and subtly, but decisively, abandon the public policy goal of assuring financial security in old age for all Americans.

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Reforming retirement policy is a long-term wager with the future, where the political risks of the prevailing system are familiar and the equivalent risks of any not-yet-running system are largely unknown. Thoughtful citizens will want to wager accordingly. ■

Endnotes

1. Provisions in the Internal Revenue Code began encouraging private retirement provisions in the 1920s but became especially prominent in World War II and flourished in subsequent years. In 1974, Federal policy further regulated private retirement plans with the protection of national standards enforced under the Employee Retirement Income Security Act (ERISA).

2. The ERISA Industry Committee, "Getting the Job Done: A White Paper on Emerging Pension Issues," ERISA: Washington, D.C., July 1996, p.12.

3. Peter A. Diamond, "A Framework for Social Security Analysis," *Journal of Public Economics*, 8(3), December 1977, pp. 275-98.

4. Steven A. Sass, *The Promise of Private Pensions* (Harvard University Press, 1996).

5. Gary Burtless and Barry Bosworth, "Privatizing Social Security: The Troubling Tradeoffs," *Brookings Policy Brief*, No.14, March 1997.

6. That all are in the same program of pooled risks does not imply all are treated in an exactly uniform way. The point is that in social insurance any differences in treatment are justified by claims of serving a social purpose and not strictly claims of individual equity. In private insurance the latter claims legitimately to select people to favor those who are healthier, higher paid, more regularly employed. By contrast the rationale of social insurance is a forced uniting of people at different risk levels.

7. This motive has for half a century been expressed in two features of the existing system. First, financial resources for consumption are transferred from better-off persons to lower-paid workers of the same generation; this occurs in the formula by which benefit entitlements are related to prior earnings. Second, generations made wealthier by economic growth have transferred resources to their less wealthy parents' generation when they have gotten old (Myers 1985).

8. Eric M Patashnik, "Unfolding Promises: Trust Funds and the Politics of Precommitment," *Political Science Quarterly*, vol.112, no.3, 1997, pp.431-452.

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