

## **Liberty vs. Dependency: The Moral Case for Privatizing Social Security**

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It's an honor to have the opportunity to speak here at the Acton Institute, an organization named after one the most dedicated proponents and defenders of liberty and morality that ever lived.

While the focus of my talk will be Social Security, the issues involved are much broader and more important than those surrounding this particular issue. The issues extend to both liberty and morality.

By way of organization, I'll begin with a basic discussion of what makes this the greatest country in the world. I'll then proceed to show how some of the very characteristics that make us great can lead to conflicts between liberty and dependency. From there, I'll discuss the importance of effective social programs that can help those in need while at the same time promoting liberty. I'll then talk about the challenge posed by Social Security and explain why reforming Social Security is necessary to promoting both liberty and the advancement of morality. Finally, I'll discuss some of the barriers to reforming Social Security, present my own proposal for reform and explain why privatizing Social Security is the right thing to do.

### **A Great Country's Heritage**

I have no doubt that the US is the greatest country in the world. What makes us great are two things—our faith in God and our belief in liberty. We are a great country because of a rich heritage that specifically involves recognition of the role of the Almighty and respect for individual liberty.

Our *Declaration of Independence* states quite clearly the basis upon which this country was founded—“...that all men are created equal, that they are endowed by their Creator with certain unalienable Rights, that among these are Life, Liberty and the pursuit of Happiness.” A nation founded on a belief in the Almighty as a source of basic rights is a nation with a solid foundation for greatness.

### **Helping those in Need—Individually & Collectively**

As a nation, our belief in God leads us to respect others. Since God creates every person, we believe that every person is inherently important. That importance means we have a responsibility to help those in need. Fulfilling this responsibility as individuals is fairly straightforward. We're called upon to assess the needs of others and contribute a reasonable portion of our resources to fulfilling those needs.

Assessing and fulfilling needs collectively, as a nation, is not as straightforward. First, it involves judgments about forcibly taking money away from some people to help others. Next, it involves using the political process to determine both the most pressing needs and the best way to fulfill those needs. When government forcibly takes money from some to help others, it can do more harm than good.

This can occur in two ways. First, forcibly taking money from people can keep those in need from helping themselves. This is true whether we are taking money from those who are poor or from those who are rich. It's obvious that taking resources from the poor (through payroll taxes or sales taxes) makes it more difficult for those in need to help themselves. It's less obvious that the same applies to taking money from the rich.

Over two centuries ago, classical economists led by Adam Smith explained that the key to economic prosperity was to make sure people had just four things—low tax rates, free markets, protection for their property and a stable currency. When we tax a productive process and take away a person's income, we violate two of these classical principles.

People work and invest to improve their well-being. When you tax something you create less of it. Taxing income discourages its creation. Research into the impact of taxes on economic performance suggests that high tax rates on the most creative, most industrious workers has the effect of making them less creative, less industrious, less productive. This reduces the wealth and income of the country and ends up hurting both the rich and poor. When rich and poor both suffer, it's the poor that suffer the most.

This doesn't mean that government should necessarily avoid social programs. It does mean government social programs must be highly efficient if they're to offset the damage from taxing those who have to pay for such programs.

Social programs themselves can create barriers that limit our freedom. In the 1960s social programs designed to help reduce poverty created financial incentives for the head of a household to leave or for young girls to have children. Perverse incentives contributed to the disintegration of traditional families and to endemic poverty for those who made use of these incentives.

### **Guidelines for Efficient & Successful Government Programs**

For social programs to be efficient and successful they should do as little damage as possible to those who have to pay for them. This means that taxes to support such programs must be as low as possible so that the support itself doesn't create problems. Wherever practical, the programs themselves should maximize individual freedom and to minimize dependency on those receiving benefits. By maximizing freedom and minimizing dependency social programs allow each individual to achieve all that their God-given talents allow them to achieve.

Regardless of how well any government social program is designed, there is a direct relationship between the power of government and individual liberty. The more power and responsibility we give to government, the less freedom we have to make individual choices. To remain a great country, it's important that we promote the correct balance between using government to help those in need while maximizing liberty for all.

## The Social Security Challenge

Nowhere is the challenge of helping those in need while maximizing liberty more apparent than in the area of Social Security. Our Social Security program was established in 1935, in the midst of the Depression. The objective was an honorable one. To supplement the income of low-income retirees so that they could help meet their financial obligations once they were no longer able to work.

Unfortunately, as with the anti-poverty programs of the 60s, Social Security is a flawed system. Politicians decided to tax current workers and to transfer the money to retirees. Politically, this was a relative easy thing to do. When regular monthly payments began in 1940 there were 159 workers for each beneficiary. With all these workers and few beneficiaries, the total Social Security tax rate was only 2% on the first \$3,000 of income. Today, there are 3 workers for every beneficiary and the total tax for retirement benefits is 14.4% of the first \$90,000. In the future, as the number of workers falls to 2 for each retiree, there will be pressure for much higher tax rates.

In setting up the system, politicians ignored a number of sound economic and moral principles. First, they chose to tax workers to pay retirees. Since promised benefits bore no relation to the taxes paid, the SS program had to be established under the Constitution's *general welfare* clause. Like it or not, Social Security payments are welfare payments. They are payments that children have to make to support their parents. This appears to conflict with the words of the Apostle Paul in 2 Corinthians Chapter 12, "After all, children should not have to provide for their parents, but parents should provide for their children."

In our Social Security system, children provide for their parents. Moreover, the political power of retired parents combined with the lack of attention on the part of their working children has progressively added more benefits to retirees. This places progressively greater burdens on those who must work to pay for these retirement benefits. In the mid-1960s, medical benefits were added to retirement benefits. Total Social Security taxes on workers have gone from 2% of wages and salaries when the program began to over 15% of income. As the number of workers to retirees decreases, the tax rates that will be necessary to pay promised benefits will increase dramatically.

This flawed system takes a large portion of each worker's income and transfers it to retirees. Both those who pay for Social Security and those who receive it suffer from a loss of freedom. The freedom and the ability of workers to save for their own retirement and provide for their children is reduced when over 15% of their income is immediately taken and given to retirees. Hence, retirees become more dependent on their children. And, since politicians determine the specifics of Social Security benefits, retirees are dependent on politicians and government to provide for a portion of their financial well-being in retirement.

Dependency has a negative impact on freedom, on incentives and on prosperity. In Europe, where tax rates for Social Security are much higher than in the US, the impact on economic performance has been dramatic. Unemployment has been in the double digits, growth has become stagnant and employment opportunities are relatively scarce.

Given the way our political system works, if nothing is done to change our Social Security program, the future conflict between workers and retirees will create bitter intergenerational conflicts. These conflicts are likely to be resolved through compromises that include higher taxes on workers and a reduction in promised benefits to retirees. This is a terrible compromise. Both workers and retirees lose. Moreover, as has occurred in Europe, higher taxes on workers means less productivity and growth. This, in turn, creates a destructive cycle that produces more pressure to raise taxes and reduce benefits.

### **The Solution—Privatizing Social Security**

There's a better way. A way that involves maximizing the freedom of individuals, the well-being of retirees and the financial condition of workers. It involves correcting the flaw in our system by privatizing Social Security. We had an opportunity to do just that in the early 1980s. At that time (as now) it was apparent that the Social Security system would be unable to meet its promises to retirees. Some proposed solving the problem by letting workers place their Social Security taxes into their own private accounts instead of transferring the funds to retirees.

This proposal was rejected. Instead, Social Security tax rates were increased and promised benefits for future retirees were reduced. I recently analyzed what might have happened if we had privatized Social Security back in the early 1980s. I assumed we had allowed all workers to place 10% of their Social Security taxes into their own private accounts. Through the years workers' assets in their retirement accounts would have grown substantially. For example, if you were a minimum wage worker in 1982 you would have earned \$7,000 that year. If you earned the bare minimum every year since then, your income last year would have been about \$13,000. Had you put 10% of your Social Security contributions into a personal account invested half in stocks and half in bonds that account would have been worth \$75,000 at the end of last year. For the typical worker, whose wage today is roughly \$45,000, his or her personal account would be worth over \$225,000. Those with incomes above that of a typical worker would have even larger amounts in their accounts.

When workers put their Social Security taxes into their own accounts, that money can't go to pay retiree benefits. The government has to replace the Social Security taxes. Since government can borrow at a lower rate than the private sector, the cost to government is less than the income the individual can earn. For the typical worker, the cost to the government to borrow (and pay interest) on the money that was no longer going from workers to retirees would have been \$112,000. Subtracting the cost to government from the amount the typical worker would have in their account leaves a net increase in wealth of \$113,000 with respect to the typical worker. If we multiply this gain by roughly 100 million workers, the net gain from privatization after only 22 years would have been over \$10 *trillion*. (My calculations and assumptions are available on my website—[classicalprinciples.com](http://classicalprinciples.com).)

In other words, by privatizing Social Security back in 1982, actual investment returns since that time suggest that we would have created more than \$10 trillion in additional assets. These are assets over and above the cost to government of borrowing every dollar needed to replace those that went into private accounts. Not privatizing Social Security in 1982 was a \$10 trillion mistake.

## **Barriers to Social Security Reform**

Earlier this year President Bush made *partial* privatization of Social Security his number one domestic priority. Instead, opposition to the President's proposal has been intense. In my book, *A Nation of Millionaires*, I noted that there were three groups who would vigorously oppose privatization. These groups are lobbyists for retirees, unions and politicians. Each of these groups has a vested interest in the current flawed system. Privatization involves a massive shift in power from these groups to individual workers.

There's a variation to the golden rule that says, "He who has the gold makes the rules." Privatization takes money that is now controlled by politicians and shifts that control to each individual. With this control each individual has more power to decide how long to remain fully and gainfully employed, when to retire, how much retirement income to take from their account and, eventually, how their assets get distributed to their children or their estate. This represents an enormous increase in power.

This power comes at the expense of others. If retirees control their retirement benefits, politicians lose power to dictate details regarding when and how much retirement benefits workers can have. Politicians also lose the contributions from those seeking influence over how benefits are distributed. There's no longer a need for lobbyists to persuade politicians of the need to protect government-controlled retirement benefits. Unions lose power to control workers who fear that a change in job would diminish their union-controlled retirement benefits. Privatization of Social Security maximizes freedom of choice by taking power that now resides with others and placing it in the hands of each worker.

There's another group that opposes privatization of Social Security that didn't exist when I wrote my book. These are people who oppose almost anything that President Bush favors. Opposition for the sake of opposition is unhealthy. In Matthew 12:25 Jesus tells us "Any country that divides itself into groups which fight each other will not last very long."

## **A Modest Proposal**

No matter how much sense it makes, regardless of how it increases wealth, liberty, freedom and economic well-being, privatization of Social Security will not occur unless there is a broad consensus for change. In an effort to reach a consensus, I would like to present a proposal I made some time ago. The proposal involves directing 10% of Social Security taxes into private accounts for the first \$20,000 of each worker's income. After the \$20,000 limit, all Social Security taxes go to government as they currently do.

Today, an income of \$20,000 for a family of three is below the poverty threshold. This proposal is biased in favor of low-income workers. These workers would have at least \$2,000 in assets for their personal accounts each year (\$4,000 if the worker had two jobs or if both spouses earned at least \$20,000 at each). Even with the limit of 10% on the first \$20,000, a 20-year old worker who received only a 2% wage increase each year would retire with roughly \$700,000 of assets in terms of today's buying power. Anyone who supplemented income slightly or who did better than a 2% wage increase would be a millionaire.

This reform promotes liberty and morality while reducing dependency. Within less than two generations it would eliminate poverty for all workers. By increasing national wealth, it would enable government programs to focus on those who weren't able to work, those who are truly needy.

I'm convinced that if the public knows what's at stake, there would be overwhelming pressure to approve such a program. Informing the public could be done with a simple TV ad. My preference would be to have a dollar amount, say \$500,000, flash on the screen. The voice of James Earl Jones would be great. How can you ignore anything said by James Earl Jones? Especially if you heard him say, "If you earn at least \$20,000 a year, this is how much you can expect to have in your own retirement account. There are those who don't want you to have this money. Lobbyists, such as AARP, certain politicians and certain union leaders currently control much of your retirement funds. When you gain, they lose."

Finally, as the \$500,000 figure flashes even larger on the screen, Jones concludes, "**All that stands between you and your money is a vote of Congress. Call your representative today and simply say—'Show Me The Money!'**"

Corny? Yes. Madison Avenue? Sure. Effective? You Bet.

## **Conclusion**

The moral case for privatizing Social Security is compelling. Privatization provides the means to end poverty among the working poor. It ends poverty, not by a gift or by taking something from others, but by simply allowing people to keep what they have earned. Overtime, the buildup of assets leads to an appreciation that even the most menial job provides value and dignity to those doing the work. Once it becomes apparent that the much-maligned hamburger flipper can accumulate great wealth, both the flipper and those who disparage such work will have a greater appreciation for its value.

As workers who never had assets begin to accumulate large sums, they will realize first hand the virtue of thrift and the power of compound interest in creating wealth. With their newfound wealth, more workers will become more interested and knowledgeable about policies needed to maintain a healthy economy and strong financial markets. As their assets accumulate, the working poor will have to deal with an issue they never had to before—what can I do to help others?

For those who truly care about helping others, privatizing Social Security is clearly the right thing to do.