PRIVATE MARKET REFORMS FOR SOCIAL SECURITY: A COMPREHENSIVE GUIDE FOR COMPOSING REFORM LEGISLATION

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TABLE OF CONTENTS

I. INTRODUCTION TO SOCIAL SECURITY'S CHALLENGES AND THE PROPOSED REFORMS .............................................. 119
   A. THE STATE OF THE SYSTEM ............................................. 119
   B. A DYNAMIC SYSTEM ..................................................... 122
   C. PRIVATE MARKET REFORM PROPOSALS ......................... 123
   D. GENERAL PARAMETERS AND OUTLINE .......................... 124
   E. GENERAL CONCLUSIONS .............................................. 126
II. GOALS OF THE SYSTEM AND THEORIES REGARDING THE ROLE OF GOVERNMENT .............................................. 126
III. EVOLUTION OF THE FUNDING STRUCTURE ....................... 128
IV. COMMON ISSUES REGARDING PROPOSED PRIVATE MARKET MODIFICATIONS ....................................................... 129
   A. INVESTMENT RISK ..................................................... 129
   B. RISK CONTROL AND PORTFOLIO THEORY .................... 130
   C. A LEGAL FRAMEWORK ................................................ 131
      1. Fiduciary Obligations and Accountability ..................... 131
      2. Investment Strategy and Evaluation ............................. 133
      3. Related Legal Changes ............................................ 133
V. A COMPARISON OF THE MAJOR PRIVATE MARKET PLANS .......................................................................................... 134
   A. PREFACE ........................................................................ 134
   B. THE FEDERAL GOVERNMENT AS THE INVESTOR AND TRUSTEE ................................................................. 134
      1. Political Support ...................................................... 134
      2. Historical Background .............................................. 135
      3. Public Pension Systems That Use Private Investments .... 135
      4. The Choice Between Passive and Active Management .......... 137
      5. Cost Reduction ....................................................... 138
      6. Risk Management ................................................... 139
      7. Political Interference ............................................... 139
   C. PRIVATIZED INDIVIDUAL ACCOUNTS ............................ 140
      1. Political Support ...................................................... 140
      2. Defined Contribution and Defined Benefit Plans ............. 140
      3. Tiered-Benefit Structure of a Partially Privatized System ... 141

117
4. Choosing the Investor .............................................................. 142
5. The Role of the Individual ....................................................... 143
6. The Annuitzation of Individual Accounts ............................... 144
   a. In General ........................................................................... 144
   b. Equitable Complications ..................................................... 145
   c. Implications for the Spouse and Family .............................. 146
7. The Means and Costs of Transition to a Privatized System .... 147
   a. In General ........................................................................... 147
   b. Varying Treatment of Different Groups of Cohorts .......... 147
   c. Administrative Costs ........................................................... 148
   d. Auxiliary Benefits ............................................................... 148
8. Income Progressivity ............................................................... 149

VI. THE CHILEAN SYSTEM: A MATURE AND FULLY PRIVATIZED SYSTEM ..................................................... 149
   A. Historical Background .......................................................... 149
   B. The Structure of the Chilean System .................................... 150
   C. The Chilean System’s Results ................................................. 151
   D. A Comparison with Social Security in the United States .......... 153

VII. THE PRESIDENT’S COMMISSION TO STRENGTHEN SOCIAL SECURITY ......................................................... 154
   A. The Life and Times of the CSSS ............................................ 154
   B. The Members and Their Mission ......................................... 155
   C. The Interim Report .............................................................. 156
   D. The Final Report ................................................................. 157
   E. Public Reactions and Politics ................................................. 160

VIII. CONCLUSION .............................................................................. 162
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“The country needs and . . . the country demands bold, persistent experimentation. It is common sense to take a method and try it; if it fails, admit it frankly and try another. But above all, try something.”
—President Franklin Delano Roosevelt

“Just putting more money in the program is like putting more gas in an old car. It still is an old car.”
—Louisiana Senator John B. Breaux

I. INTRODUCTION TO SOCIAL SECURITY’S CHALLENGES AND THE PROPOSED REFORMS

A. THE STATE OF THE SYSTEM

The Social Security system is undoubtedly one of the most important public programs in the history of the United States. Established during the Great Depression, it was intended to provide a minimum level of income to the elderly in their retirement. Since the birth of the program, the system has greatly expanded through a series of amendments so that it now covers over 96% of the country’s workforce.

Generations of unbalanced fiscal policy and serious demographic changes now portend excruciating challenges for the Social Security system. As the “cohorts” and legions of Baby Boomers inexorably march

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5 See Nickles, supra note 3, at 81.

119
toward their retirement, the benefit checks to which they are entitled under the current law will drain the system of its scarce resources. The trust funds, where surplus payroll taxes enjoy a short interest-earning sojourn, will be completely drained within just a few decades. In 2016, the system will begin to pay out more than it takes in. At the inevitable point of insolvency, now predicted to occur in 2038, the system will only be able to pay approximately three-quarters of the benefits that it now promises. With the passage of time, the problem will grow even more acute, and the proportion of current benefits that the system can afford to pay will decrease to about two-thirds of the current level by 2075.

In the past few years, predictions about the health of the Social Security system have modestly improved. The nation’s strong economic performance during the Clinton administration succeeded in rolling back the date of insolvency numerous times. As a result, the system’s predicted solvency inched and lurched along, gaining two years in 1999, three years in 2000, and yet one more year in 2001. The general weakening of the economy during 2001 and the national and global economic turmoil caused by the tragic terrorist attacks in the United States on September 11, 2001, however, will undoubtedly have at least some negative impact on the progress made in recent years. In order to preserve this vital social program far into the distant future, it is important that Congress enact some new and fundamental changes to its structure.

As a means of addressing the problems that face the system, President George W. Bush issued an Executive Order that created a commission charged with developing a plan of reform. The bipartisan Commission to Strengthen Social Security (“CSSS” or “Commission”) was co-chaired by former Senator Daniel Patrick Moynihan (D-NY) and Richard Parsons, the co-Chief Operating Officer of AOL-Time Warner. All of the commissioners selected by the President supported the creation of
The guiding principles for the Commission were narrowly tailored, and their plans required a provision for some form of voluntary, individually controlled retirement accounts.\textsuperscript{14} The Final Report of the CSSS was released in December 2001, and it will likely serve as the starting point for a new chapter in the life of Social Security.\textsuperscript{15} The report contains three specific proposals to the President.\textsuperscript{16} All three proposals have a number of elements in common. They provide for the creation of voluntary private accounts into which workers would be permitted to redirect a portion of their payroll taxes.\textsuperscript{17} It is theorized that the rate of return on the selection of investment portfolios will exceed the reduction in the traditional Social Security benefit. This tradeoff would enable investors to obtain a higher total benefit than they would have received under the original system.\textsuperscript{18} Participating workers would own their accounts and have the right to bequeath their accounts to their heirs.\textsuperscript{19} Advocates expect that this reform will lead to increased national saving and wealth creation.\textsuperscript{20}

The CSSS’s reform models also differ in a number of important respects. The three models vary in the percentage and amount of the payroll tax that workers would be allowed to redirect to their private accounts.\textsuperscript{21} As a consequence, the reduction in the guaranteed Social Security benefits also differs among the three models.\textsuperscript{22} Reform Models 2 and 3 would improve the long-term solvency of the system, but additional federal revenues would be required for a period of years to make the system sustainable.\textsuperscript{23} Reform Model 1, however, would not achieve long-term solvency.\textsuperscript{24} Models 2 and 3 contain a number of progressive elements that increase benefits for low-income workers and survivor’s benefits for widows and widowers with below average incomes, while the Model 1 makes no such provisions.\textsuperscript{25} In addition, the last two models contain some important changes to the benefit calculation.\textsuperscript{26}

The Final Report faces special political, economic, and financial obstacles due to the September 11\textsuperscript{th} tragedy. The “War on Terrorism” and the nation’s exacerbated economic woes have led to a reshuffling of the national political agenda. Whereas at the beginning of President Bush’s first term, he made Social Security a primary issue, in his 2002 State of the

\textsuperscript{16} See generally \textit{PRESIDENT’S COMM’N TO STRENGTHEN SOC. SEC., supra} note 7.
\textsuperscript{17} Id. at 10.
\textsuperscript{18} Id.
\textsuperscript{19} Id. at 14.
\textsuperscript{20} Id.
\textsuperscript{21} Id. at 11.
\textsuperscript{22} Id. at 11–14.
\textsuperscript{23} Id. at 12–14.
\textsuperscript{24} Id. at 11–13.
\textsuperscript{25} Id. at 11–12.
\textsuperscript{26} Id. at 11.
\textsuperscript{27} Id. at 12–14.
Union Address, it received only the briefest of mentions. Also, the President and Congress must pay serious attention to reviving the economy.

In addition, the party composition of Congress will be critical to the type of reform proposal that is eventually enacted. A Congress controlled by the Democrats would surely be less receptive to the reform plans of the President and the CSSS than would a Republican controlled Congress. Because, the political makeup of Congress after the 2002 elections could in part depend on the public perception of how the President and Congress handle the terrorist crisis and the nation’s economic recovery, politics and timing will, as usual, play key roles in any reforms that are ultimately passed.

B. A DYNAMIC SYSTEM

The Social Security system is no stranger to change. In fact, the system’s original design created a substantial reserve that would protect against the very danger of bankruptcy that now looms in its future. Early on, however, legislators decided to pay higher benefits to retirees and to include more beneficiaries an unfunded system. This policy shift, along with the nation’s demographic transformation, has led to the creation of long-term Social Security budget deficits that will need to be covered. Although, these unfunded liabilities currently stand at $10 trillion, there is still great hope and the opportunity for the government to devise a workable solution. Not since the days of the Articles of Confederation has the United States government defaulted on its debt.

For years, politicians have enacted a myriad of adjustments and patches to improve the health of the Social Security system. These changes have included increased payroll tax rates, benefit reductions, and an increase in the age of eligibility to receive benefits. A combination of numerous possible tinkerings and adjustments could put the system in long-term fiscal balance. The series of changes must have the aggregate effect of increasing cash inflows by 1.86% of the taxable payroll. While a number of these changes will certainly prove helpful, the system is in need of important structural modifications that will reduce the payment burden of the workers and employers and the benefit sacrifice by cohorts.

30 Id.
33 Nickles, supra note 3, at 91.
34 Id.
35 Id. at 93.
37 See 2001 TRUSTEES REPORT, supra note 8, at 6.
C. PRIVATE MARKET REFORM PROPOSALS

Scholars, politicians, and committees have proffered a variety of plans to deliver the system’s salvation. Many, if not most, of the proposals that address the long-term deficit include a component of greater advance funding and private investment. Such changes attempt to harness the growth potential of the private capital markets to boost the return on payroll contributions. In this way, market forces shoulder some of the burden that workers and cohorts previously bore alone.

While the various reform plans differ in detail, they can generally be bifurcated into two major groups: governmentally administered trust funds and “privatized” plans. The former type of plan is arguably the least drastic of the two, since it calls for the government to shift the trust fund investments from special Treasury securities to investments in private markets. The privatized plans, on the other hand, would allow investors themselves to redirect a portion of their payroll tax contribution away from the current system into individually funded accounts.38

Both major proposals would potentially allow workers’ retirement funds to grow and compound at a higher rate of return than they would under the current investment scheme. At the heart of the conflict between the systems is a fundamental philosophical difference in the supporters’ attitudes toward the size and role of government.39 The governmentally administered system vests in the government a larger role than it has under the current scheme. The privatized system places more emphasis on the individuals and their freedom to choose the assets that will finance their retirement.

The various models of reform have been hotly debated on Capitol Hill and in reams of academic literature for many years. In fact, the current “public-private” argument is no more than an evolved species of the debate that began over the seminal Social Security legislation in 1935.40 Unlike many similar political arguments that involve theoretical constructs and predictions, there exists a great deal of empirical data on the subject.

Latin America has served as a virtual laboratory for experimentation in privatized reforms. Many different Latin American models of reform, with varying degrees of investment freedom, have been put in place over the last decade.41 Most notable is Chile’s successful and sophisticated system that has been in place for two decades.42 For those who argue that the societies and economies of emerging market nations are too different from that of

38 Most studies presume that a government-managed system will have a single fund and that the government will act as the trustee. It is possible, however, that a system of private accounts can be created under the auspices of the government.


41 Id.

the U.S. to allow for meaningful comparison, it should be noted that many industrialized nations, including the United Kingdom and Canada, have engaged in similar private market reforms.

Throughout the 1990’s, many privatization bills were introduced in Congress. Former President Bill Clinton outlined his own plans in his 1999 State of the Union address. President George W. Bush has addressed Congress on the merits of reform based on personal accounts and established the Commission to Strengthen Social Security to develop such a plan. Also striking is that for the first time in recent memory, the opening text of the annual report from Social Security’s Trustees has made mention of the need to benefit from the “return on private capital.”

In light of the proposal of the CSSS and the support of the President and his Treasury Secretary, Paul O’Neal, there is a good chance that there will be serious Congressional debates on personal account reform within the next few years. The battle on Capitol Hill will undoubtedly be intense but it is not likely that any Social Security reform legislation will be enacted until after the midterm elections in 2002. If the economy and the outlook of the market improve, and if the fears of the public are allayed, the moderate-conservative political bias on the Hill may ultimately result in the system’s utilization of private markets in some form or another.

D. GENERAL PARAMETERS AND OUTLINE

This Article attempts to explore the difference between the two major schools of thought or plans for private market reforms in the Social Security system. Aside from outlining some of the economic consequences of the competing proposals, it will explore the legal changes and structure necessary to implement and safeguard the retirement pensions of the nation’s workers.

As with any important change in our political system, it is extremely important to understand the situation from a political perspective. It is not surprising that some solutions, no matter how logical, are just not viable in light of prevailing political attitudes. Therefore, some reforms that might...
excite academics, economists, and policy wonks would be doomed to fail if not altered and made politically palatable. Since logic and careful thought cannot always be poured into the mold of politics, compromise, and popular opinion, such alterations might prove fatal to many worthy plans.

This Article covers a host of topics, although it is by no means an exhaustive exploration. The first three Parts attempt to lay a foundation for the debate on the private market alternatives. Part II examines Social Security’s goals and the different roles that the government can play in the system’s administration. Part III describes the evolution of the system’s funding, and Part IV details some of the common issues involved in private market modifications.

After this “base” and “scaffolding” have been erected, the Article analyzes the “superstructure” of the major private market alternatives that have been suggested as replacements for the current Social Security system. Part V describes in great depth the issues that arise where the government acts as the investor and the proposals for a system of individual personal accounts. In a comparative analysis, Part VI outlines the blueprints of the Chilean edifice that has stood for over a generation. Finally, Part VII discusses the role and reports of the Presidential Commission to Strengthen Social Security and the political and economic issues that will influence the enactment of any proposal.

Before continuing, it is necessary to point out some of the parameters used in developing this Article. The system generically referred to as “Social Security” is composed of three trust funds and four major programs that cannot be studied in isolation from one another: (1) Old Age Survivor Insurance (“OASI”), (2) Disability Insurance (“DI”), (3) Health Insurance (“HI”), and (4) Supplemental Security Income (“SSI”). The core of this report, however, focuses only on the OASI program and fund. This Article will not examine the oft-debated Medicare privatization reforms.

Although the Article is not an evaluation of the many bills or plans proposed in recent years, particular attention will be paid to the Final Report and plans of the CSSS.

The Article is not meant to be a mere synopsis of prior studies. It is an attempt to add value, cohesiveness, and insight into the often chaotic and chronically partisan debate. It should be used as a basis for coherent debate and as a prelude to comprehensive reform legislation. While the Article offers legal and policy recommendations based on professional studies, it does not make specific financial predictions nor does it proffer actuarial conclusions.

to save the system, a proposal that was precluded from being implemented because of current attitudes on the balanced budget).

52 See, e.g., Robert Pear, Medicare Panel Chief Doubts He’ll Find Votes for Change, N.Y. TIMES, Mar. 16, 1999, at A25 (describing a market-based reform for a health insurance system proposed by the Bipartisan Committee on the Future of Medicare). The Committee proposed that rather than having each medical service paid for, based on the theory that competition among health care providers in the market place would lead to lower prices and greater efficiency, each beneficiary would receive a fixed amount of money to purchase a health care plan. Id.
The Article attempts to provide a politically neutral understanding of the goals of Social Security and how solvency might best be achieved. A conscious attempt was made to frame the debate impartially without regard to the personal views of the authors. Readers are encouraged to draw their own conclusions, and are urged not to make up their minds about the nature of the needed reforms before having weighed unbiased actuarial and economic information. They should pay close attention to the sources and take care to compare competing versions of the information. Readers should also strain to avoid reading their preferences into the numbers and data. If the goal of this project is achieved, when the scaffolding around the study is razed, the remaining structure will be able to stand on its own without leaning toward either side of the political spectrum.

E. GENERAL CONCLUSIONS

Despite the impartial nature of this Article, a few general conclusions should be drawn from this critical examination of the system alternatively thought of as a sacred cow, a gigantic pyramid scheme, or the “third rail” of American politics. These conclusions are offered for the readers to ruminate upon as they read further:

(a) No single private market scheme is the magic elixir that will preserve the current benefit structure;

(b) Although the leaders of the two major political parties have edged closer in their recommendations for reforms involving private markets, there is still a large gap to bridge and an enormous amount of work that remains to be done;

(c) The plan requires a sound legal and economic structure to safeguard the assets that belong to the American people; and

(d) Most importantly, the plan that is ultimately chosen must be implemented soon so that it can be phased in properly and take advantage of the time value of money.

The nation’s political leaders must realize that the path of inaction leads to a miserable dead end. Without a sound solution and its timely implementation, students of law, economics, and political science may very well study the contemporary Social Security system under a new course title: Legal History.

II. GOALS OF THE SYSTEM AND THEORIES REGARDING THE ROLE OF GOVERNMENT

In order to choose the most adequate approach for reforming Social Security, it is necessary to outline what the goals of the system should be.

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53 DERTHICK, supra note 40, at back cover.
54 Solomon & Barrow, supra note 1, at 9.
56 See SOCIAL SECURITY FINANCING, supra note 44, at 4, 51.
The system is a product of a socially and economically turbulent era of American history. Thus, like the arboreal rings of a venerable old tree, it bears the markings of its past. For although Social Security was implemented during the Great Depression,\textsuperscript{57} the paternalism that permeates the program is still tinged by a pre-Depression belief in individualism and self-reliance.\textsuperscript{58}

The system has long striven to balance two important goals, sometimes articulated as “social adequacy” and “equity.”\textsuperscript{59} The adequacy goal is evidenced by the system’s attempt to provide the beneficiary with a certain standard of living regardless of their contribution to the system.\textsuperscript{60} It encompasses the notions of welfare, individual need, and a degree of income transfer.\textsuperscript{61} On the other hand, the equity concept holds that recipients should receive benefits that are directly related to their contributions.\textsuperscript{62} This last concept serves as the basis for Social Security’s characterization as a system of social insurance.\textsuperscript{63}

When Social Security was signed into law in August of 1935,\textsuperscript{64} its original design placed an emphasis on equity.\textsuperscript{65} The original legislation was quickly amended to fund a greater level of benefits to payees, to fund more auxiliary benefits, and to include more eligible, contributing workers.\textsuperscript{66} Benefit levels were still calculated with a formula that reflected the workers’ contributions, but the new system paid out to retirees more than they had contributed during their working years.\textsuperscript{67}

The aforementioned financial structure can be maintained only so long as either the number of contributors, the economy, or both are growing.\textsuperscript{68} The strain of demographic changes, however, particularly the impending Baby Boomers’ retirement and the decrease in the dependency ratio, make this impossible.\textsuperscript{69} Therefore, the government must make a number of important decisions regarding the reform package and the mode of restructuring in order to restore long-term fiscal solvency. This is likely to reopen and rekindle the incendiary debate over the proper balance between equity and adequacy.\textsuperscript{70}

\textsuperscript{57} Olavarria-Gambi, \textit{supra} note 42, at 165.
\textsuperscript{58} Solomon & Barrow, \textit{supra} note 1, at 10.
\textsuperscript{59} Moore, \textit{supra} note 29, at 162.
\textsuperscript{60} See \textit{id.} at 163.
\textsuperscript{61} See Solomon & Barrow, \textit{supra} note 1, at 14.
\textsuperscript{62} Moore, \textit{supra} note 29, at 162–63.
\textsuperscript{63} Solomon & Barrow, \textit{supra} note 1, at 14.
\textsuperscript{64} Moore, \textit{supra} note 29, at 134.
\textsuperscript{65} \textit{Id.} at 163.
\textsuperscript{66} \textit{Id.} at 134.
\textsuperscript{67} See Kollmann, \textit{supra} note 4, at 2–4.
\textsuperscript{68} See Moore, \textit{supra} note 29, at 142–43.
\textsuperscript{70} See Moore, \textit{supra} note 29, at 163–65.
One of the aims of the privatization legislation is to move the Social Security system from its partially funded status toward a state of full funding. Throughout its history, the system has shifted along a spectrum, moving between a state of being fully funded and a state of being completely unfunded. Both modes reflect different views regarding the size of government and the role that it should play as trustee of the citizens’ money.

An unfunded, or “pay as you go” (“PAYG”), system allows workers to keep more of their salary to either save or consume. A PAYG system, however, is vulnerable to unexpected decreases in cash inflows. In essence, its operation is analogous to running a marathon with one’s head down. In such a stance, one can hardly ever be proactive, only reactive. Concentrating on nothing but the next stride does little to aid in the avoidance of potholes before it is too late.

The primary funding for the Social Security system, including all three major trust funds, is the mandatory payroll tax. The original Social Security Act required all eligible employees and their employers to contribute a 1% tax on the first $3000 of the employee’s income. Under this payment scheme and due to wage growth during World War II, the system amassed a substantial reserve that could be used to address funding problems that might arise in the future. Advance funding also allowed for the added benefit of investment of the surplus funds in special Treasury securities.

Despite the now obvious wisdom of such a prefunded system, the reserve account was harshly criticized, and the 1939 Amendments led to a major change in policy. Congress decided to pay out these additional funds despite the objection of both the system’s Trustees and President Roosevelt. In this way, Social Security was converted into a PAYG system, and money from payroll taxes went directly from the paychecks of current workers to the pensions of retirees without the benefit of first accumulating interest. The system’s financial structure continued in this form from 1939 until 1977, during which time Congress tinkered with tax rates and benefit amounts.

By 1977, shifts in demographics and the economy required stronger corrective measures than the tinkering of years past. In 1977 and 1983, the system moved away from a purely PAYG basis to a state of partial funding. Perhaps the most important amendments were enacted in 1983 upon the
suggestion of the National Commission on Social Security Reform, chaired
by Alan Greenspan.78 The primary recommendations of this committee
included the accumulation of a reserve fund, an increase in payroll taxes, a
decline in benefits, and a gradual rolling back of the retirement age.79
While the reforms of 1983 were some of the strongest enacted up until that
time, the system was still not perpetually viable as a going concern. The
reforms were meant to solve the deficiency within a seventy-five year
horizon and were not intended to be a permanent solution.

Under current law, nearly all of the working population is covered.80
The working population is required by either the Federal Insurance
Contribution Act (“FICA”)81 or the Self Employment Contribution Act
(“SECA”)82 to contribute payroll taxes. Currently, employees and their
employers each pay a tax of 6.2% on the portion of the employee’s
income83 that falls below an annually adjusted taxable wage.84 Self-
employed workers contribute the entire amount themselves, but they are
eligible for a tax deduction for the amount that an employer would
contribute if they were employees.85 Surplus monies are deposited in trust
funds that are invested in government bonds.86

IV. COMMON ISSUES REGARDING PROPOSED PRIVATE MARKET
MODIFICATIONS

A. INVESTMENT RISK

The greatest challenge faced by the Social Security system is its
projected inability to pay the promised level of benefits in the future. The
two major private market plans both attempt to close this gap through the
investment of the trust funds in the capital markets for financial
instruments. The historical average rate of return on equities is about 7%
per annum over the past one hundred years.87 This has greatly exceeded the
rate of return on the risk-free Treasuries, which have yielded approximately
2.7% annually.88 The benefits of higher potential returns, however, carry an

78 Solomon & Barrow, supra note 1, at 15.
79 KOLLMANN, supra note 4, at 16-17.
80 See Moore, supra note 29, at 145.
82 Id. §§ 1401-03.
83 Id. §§ 3101 (a), 3111 (a).
84 KENNETH S. APPEL, SOC. SEC. ADMIN., COST-OF-LIVING INCREASE AND OTHER
(Oct. 18, 2000).
86 Social Security Act, 42 U.S.C. § 401 (1994). See also SOCIAL SECURITY FINANCING, supra note
44, at 36 (noting that the Secretary of the Treasury, who is the Managing Trustee of the Social Security
system, is required to invest in special Treasury securities, unless the Secretary determines that
purchasing marketable Treasury securities or agency securities is in the public interest); 42 Op. Att’y
Gen. 327 (1966) (explaining that although it is not customarily done, the Secretary could purchase
(“FNMA”), or other similar obligations).
87 SOCIAL SECURITY FINANCING, supra note 44, at 6.
88 Id.
increased level of risk. It is important that all privatization proposals acknowledge and deal with this fact.

Many critics point out that equities are neither guaranteed to perform up to the level of their historical returns, nor need they perform better than Treasuries.\(^89\) Indeed, anyone familiar with the market would quickly concede that for any discrete period of time, all stocks have the potential to yield a return that is lower than the risk-free rate. Also, corporate bonds, which are not guaranteed by the federal government, carry the risk of default.

### B. RISK CONTROL AND PORTFOLIO THEORY

The mere presence of risk is not a reason to abandon the use of equity investments or corporate debt as a means of improving Social Security’s finances. In fact, if addressed properly, the risk characteristics of any individual asset could greatly help the system. Portfolio theory, which is part of the bedrock of modern financial theory, scientifically harnesses the risk characteristics of individually risky assets.\(^90\) It reduces the assets’ combined risk and improves the returns of a group of assets when measured together.\(^91\) Fortunately, the law has acknowledged these financial science theories, at least to some degree. Hence, it provides a basis for the development of a sound legal structure that might safeguard the system.\(^92\)

Portfolio theory seeks to maximize the return on investments while simultaneously minimizing risk.\(^93\) This financial science allows investors to avoid the necessity of creating a portfolio composed of the least risky assets by permitting investors to create a portfolio with the optimal combination of assets.\(^94\) This can be accomplished because risks of individual assets in a portfolio are not additive and can therefore be reduced in the aggregate by diversification.\(^95\) Portfolio diversification works because stock prices do not move together in a synchronized manner.\(^96\)

Individual assets carry two major risks: unique risk (or company risk) and market risk.\(^97\) Unique risk is company specific, and because investors

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\(^89\) See Moore, supra note 29, at 132–33.
\(^91\) Id. at 995–96.
\(^92\) See RESTATEMENT (THIRD) OF TRUSTS § 227 (1990).
\(^93\) See Weiss, supra note 90, at 995.
\(^94\) Id. at 996.
\(^95\) Id. at 995.
\(^96\) Covariance represents the tendency of any pair of random variables (e.g., stock prices) to move together. Numerous factors and variables in the market affect stock prices. The share prices of any two companies might move in the same or opposite directions, although not necessarily by the same amount or percentage per share. The “correlation coefficient” is a useful standardized measure that can be used to compare the covariance of different asset pairs. Choosing stocks with negative correlations (between -1 and 0) means that the two stock prices will tend to move in opposite directions. Choosing stocks with positive correlations (between 0 and +1) means that the prices tend to move in the same direction. Richard Brealey, Stewart C. Myers, & Alan J. Marcus, Fundamentals of Corporate Finance 230–31 (1991); Robert W. Kolb & Ricardo J. Rodriguez, Principles of Finance 185–88 (1995). \(^97\) Weiss, supra note 90, at 995.
are not necessarily compensated for bearing it, they will choose to eliminate it through the scientific and rational combination of assets. After diversification, all that remains is market risk—the risk that the market will rise or fall as a whole.

The current investment strategy for the Social Security system is a fairly banal one. The statutes and precedents create what is now essentially a mechanical Hobson’s choice of investing in Treasury securities. In 1966, however, the Attorney General opined that Social Security funds could be invested in the financial obligations of federal agencies that are implicitly backed by the credit of the US government. Despite the blessing of the Attorney General, the Secretary of the Treasury has not made such investments.

Whether Social Security law ultimately allows for investment in private securities markets or whether individuals are given a greater role in choosing their own investmentst, portfolio theory is of immense importance. To omit such requirements would subject the future of all prospective retirees to needless risk.

C. A LEGAL FRAMEWORK

1. Fiduciary Obligations and Accountability

It is exceedingly important that the reform legislation crafted for the Social Security system reflect sound financial theory and provide flexibility for future theoretical financial innovations. An important source of law and starting point regarding the administration of trusts is the Restatement (Third) of Trusts. Foremost among the principles of modern trust law is the rule that assets must be prudently chosen and diversified as part of an overall investment strategy. As intuitive as this financial principle now seems, for decades the law did not endorse this principle. The Restatement (Second) of Trusts permitted the use of an individual prudence standard, and thus failed to require that assets be evaluated properly with respect to one another.

While the flawed theory of individual prudence was cured, there is still another potentially problematic section remaining in the current version of the Restatement of Trusts. Section 228 actually grants a trustee

98 Id.
99 Id.
100 SSA § 401.
101 SOCIAL SECURITY FINANCING, supra note 44, at 37 (referring to 42 Op. Att’y Gen. 327 (1966)). Such financial obligations include securities issued by GNMA, FNMA, and other home credit and Federal Farm entities.
102 See Weiss, supra note 90, at 1014.
103 RESTATEMENT (THIRD) OF TRUSTS (1990).
104 See id. at § 227; Weiss, supra note 90, at 1004.
105 See RESTATEMENT (SECOND) OF TRUSTS § 227 (1959); Weiss, supra note 90, at 1004 n.27.
106 See Weiss, supra note 90, at 1004–05.
107 Id.
an exception from the requirement of portfolio diversification when it is prudent not to diversify. The comments for this section limit the trustee’s ability to opt out of this rule to the event of widespread economic downturn or the event that funding for the account is extremely limited. These exceptions have become known as the “unless prudent not to exceptions,” and they have been incorporated into the Employment Retirement Income Security Act (“ERISA”).

Despite the limitations that law has placed on the exceptions to the general rule, they have become quite problematic in the context of ERISA’s fiduciary duty requirements. Courts have been reluctant to find trustees liable for breach of fiduciary duty for failure to diversify their investments. Notably absent from ERISA is a definition of diversification. Courts will not find liability if the investments chosen were individually prudent, and courts have been unwilling to hold employers liable for a breach of duty if they have acted in good faith in making their selection. The net result has been the loss of ERISA’s diversification requirement.

The drafting flaws that characterize ERISA have not been excessively problematic in the statute’s operation. They do, however, remain a cause for concern. The titanic size of a privatized Social Security system and its overwhelming importance essentially make it too big to fail (or too big to sink). Therefore, new Social Security legislation will require some definite improvements over ERISA and the Restatement (Third) of Trusts. Aside from a definition of and an explicit requirement for “diversification,” the statute will require some fleshing out of the prudent investor rule with the basic tenets of portfolio theory. While the comments of the Restatement (Third) note the wisdom of eliminating unique risk (i.e., diversification), the comments also explicitly refuse to endorse any particular investment or economic rules.

Aside from fiduciary obligations, both major Social Security reforms will also require laws and regulations that promote the accountability of fund managers. If the government acts as the investor, power must be vested in a nonelected, nonpartisan body. The managers must be professionally trained, highly skilled, and selected on the basis of proven track records. A fairly comprehensive list or reference to other laws of trusts or securities should define malfeasance on the part of managers. In the event of such malfeasance or nonfeasance, the law should provide for the manager’s removal or impeachment. Perhaps most importantly, the federal government should be willing either to purchase insurance or to indemnify a portion of any significant losses that the trustees may cause.

See Restatement (Second) of Trusts § 228 (1959); Restatement (Third) of Trusts § 228 (1990).

See Restatement (Third) of Trusts § 228 cmt. c (1990).

Weiss, supra note 90, at 1005–07.


Weiss, supra note 90, at 1006 & n.38.

Id. at 1006–07.

See Restatement (Third) of Trusts § 227 cmt. e (1990).

Weiss, supra note 90, at 1007–08 & n.45.
2. Investment Strategy and Evaluation

Due to the dynamic nature of the market, performance and yield requirements are significantly more difficult to define than duty requirements. Passive investment strategies will track a given segment of the market.\textsuperscript{117} But if such a strategy were mandated and later found to be imprudent, it would be unfair to punish fund managers for the natural ebb and flow of the market.\textsuperscript{118} In some cases, investment strategies may be unique in design. In the case of tailored, government-administered strategies, there should be a periodic, comprehensive performance evaluation. If the investments result in underperformance for a significant period of time, there should be a mechanism for removing and replacing the fiduciary or for a changing of the strategy.

The dialectic for regulating the administrators of individual accounts should be somewhat different from the regulation of the government trustee. Since the potential for return increases with the risk assumed, individuals should be able to choose among a number of different fund managers and investment portfolios in the free market. Therefore, if the returns of any particular administrator were perennially low, that administrator would be punished and forced to change by the market of customers. There should also be a performance gauge, however, to ensure that administrators provide some minimal level of return over a particular period of time. The time periods for evaluation should be long enough so as not to deter rational (market) risk taking by fund managers.\textsuperscript{119} They should also be long enough to determine whether long-term plans have a chance of yielding their theorized returns.\textsuperscript{120}

3. Related Legal Changes

Besides the aforementioned amendments, which would need to be incorporated into existing Social Security legislation, a number of other important changes will have to be made. These include modifications to budgetary laws and investment laws. Under either plan, it would seem wise to “cut Social Security loose.”\textsuperscript{121} Currently, the trust fund is largely fictional.\textsuperscript{122} It is aggregated with the rest of the federal budget,\textsuperscript{123} and Congress routinely borrows from it. For this reason, the actual size of the federal budget deficit is disguised. Cutting Social Security loose would provide a clearer picture of the system’s financial status and a separate, candid shot of the rest of the government’s budget. Clearer accounting

\textsuperscript{117} See id. at 996–98.
\textsuperscript{118} See id. at 997–98.
\textsuperscript{120} Id.
\textsuperscript{121} Charles J. Zwick & Peter A. Lewis, Should We Cut Social Security Loose?, N.Y. TIMES, Mar. 4, 1999, at A25.
\textsuperscript{123} Id. at 19. See Zwick & Lewis, supra note 121, at A25.
would also make legislators more hesitant to openly borrow from the Social Security budget to fund other programs.

In the area of investment law, it is crucial to realize the large market effects that may be caused by any shift in Social Security policy. Social Security’s “flight” from Treasury securities will leave the Treasury without one of its largest creditors, thereby forcing the government to issue additional bonds as a substitute for needed funds. The presence of so much new money in the market could artificially drive up the prices of securities, and the inflated prices would erode yields. On the other hand, when the investments are sold to pay out benefits to the Baby Boomers, the investment prices will face downward pressure as the Baby Boomers sell off investments in other pension funds.

V. A COMPARISON OF THE MAJOR PRIVATE MARKET PLANS

A. PREFACE

The choice between a system administered by the federal government and a plan with individual accounts will depend on a number of factors. Foremost among these factors will be the ideological choice regarding the size and role of government in the lives and decisions of citizens. Also important are: the appropriate balance of investment freedom and paternalism, the tradeoff between the advantages of market-based competition and the efficiency of a single trust fund, the ability to allocate risk and absorb loss in the market, and the tradeoff between adequacy and equity.

B. THE FEDERAL GOVERNMENT AS THE INVESTOR AND TRUSTEE

1. Political Support

The private investment of the prefunded Social Security surplus, with the government as the administrator, has received a great deal of recognition in recent years. It was supported by six of the members of the 1994–1996 Advisory Council on Social Security, TIAA-CREF, and President Clinton. It is also the method that Canada uses to manage its analog to the Social Security system, the Canadian Pension Plan (“CPP”).

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124 See SOCIAL SECURITY FINANCING, supra note 44, at 53–54.
125 Id. at 3, 20.
127 Moore, supra note 55, at 351 & n.44.
128 SOCIAL SECURITY FINANCING, supra note 44, at 23.
2. Historical Background

The proposal that the government act as investor and trustee is not altogether different from the management of the current Social Security system. In fact, in many ways, it is actually quite surprising that this alternative has not already been implemented. After years of strong stock performance and market worship throughout the 1980’s and 1990’s, it seems anachronistic that the system still relies upon investments in comparatively low-yielding Treasury securities.

At the time that the Social Security system was debated and signed into law, the economy and financial markets were recovering from their decimation during the Great Depression. Unemployment had reached 21.7%, the Gross National Product (“GNP”) had fallen by 25%, and the stock market had lost over 70% of its value. The speculative boom that had contributed to the collapse of the stock market, the embryonic financial and securities legislation, and the fledgling role of the Federal Reserve painted a far different picture than that of the healthy financial landscape to which we are now accustomed.

While the earlier momentum for a social insurance system was squelched by the prosperity of the 1920’s, the Great Depression provided a new backdrop for the debate. Under the stewardship of President Franklin Roosevelt and a cooperative Congress, the government took on a new paternalistic role to navigate the nation out of the tempestuous socioeconomic maelstrom. The comfort of the government guarantees on Treasury securities was clearly attractive because the U.S. government, even in the economy’s darkest hours, had never defaulted on its financial debt obligations.

3. Public Pension Systems That Use Private Investments

In the generations since the Social Security system was born, financial markets have greatly evolved in the United States and throughout the rest of the world. The system’s trustees now assume that if the trust funds are invested in Treasury securities, under intermediate assumptions, they will earn only 2.7% annually after inflation. Contrast the historical return of equities over the past one hundred years which is close to 7% per year.

While investing in stock entails greater risk, it also provides the potential for greater returns. It is important to note that the annual returns for stocks have fluctuated greatly over time, and in some years, and even decades, the stock market has had negative rates of return. While it is almost certain that the long-run yield on stocks will be greater than that on

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129 Moore, supra note 29, at 133.
130 Solomon & Barrow, supra note 1, at 11.
131 2001 TRUSTEES REPORT, supra note 8, at 2.
132 SOCIAL SECURITY FINANCING, supra note 44, at 6.
133 Id.
134 Id. at 7.
135 Id. at 38.
136 Moore, supra note 29, at 154.
Treasuries, there is no guarantee that the market will return the long-run historical average rate.\textsuperscript{136}

Despite the augured problems and calamities, many public pension plans have performed quite well, rivaling their private counterparts. Professional studies conducted by the Trust Universe Comparison Service ("TUCS") and Wilshire Associates have shown that the returns on public plans have been virtually the same as their corporate analogs.\textsuperscript{137} At most, the public plans have yielded one percentage point less—a difference thought to be the result of asset allocation.\textsuperscript{138} To put this difference in perspective, in 1999, state and local pension funds achieved annually compounded returns of over 17% in a ten-year period.\textsuperscript{139} In 1999, these public funds, with nearly 67% of their portfolios invested in equities, of which 80% was invested in domestic companies, owned about 11% of the U.S. equities market.\textsuperscript{140} Some of the best-known public funds that play a large role in the market for private securities include the California Public Employees' Retirement System ("CALPERS") and the New York State Common Retirement Fund.\textsuperscript{141}

At the time that the General Accounting Office ("GAO") released its study on the effects of government stock investing, under the most aggressive scenario, the effect of shifting the investment of the trust funds from risk-free securities to equities was significant enough to add eleven years to the solvency of the program.\textsuperscript{142} While the study contains a plethora of assumptions, this forecast is valuable for several reasons. Most importantly, it demonstrates the inability of stock investing alone to solve the funding problem facing Social Security. Whether private market investment is used in the context of a single government-managed fund or private individual accounts, the solution will also require attendant adjustments in the amount of benefits, the size and cap of the payroll tax, and the age of retirement.\textsuperscript{143} Indeed there are innumerable combinations of changes that can be made.\textsuperscript{144} Particularly important is the haste with which the transition is made so as to capitalize on the private market’s potential to produce higher average returns.

The appointment of the government as the trustee has great ideological implications, and there are many potential advantages and disadvantages to this choice. The Final Report of the CSSS fails to acknowledge many of these benefits,\textsuperscript{145} and it does not describe any means of counteracting the

\textsuperscript{136}SOCIAL SECURITY FINANCING, supra note 44, at 41.
\textsuperscript{137}Mark A. Sarney, State and Local Pension Plans’ Equity Holdings and Returns, 63 SOC. SEC. BULL. 12, 15 (2000).
\textsuperscript{138}Id. at 12, 15.
\textsuperscript{139}Id. at 12.
\textsuperscript{140}Id. at 12, 14.
\textsuperscript{141}Id. at 13.
\textsuperscript{142}SOCIAL SECURITY FINANCING, supra note 44, at 6–7 (predicting that solvency would be extended from 2029 to 2040, under the most aggressive scenario).
\textsuperscript{143}Id.
\textsuperscript{144}Id. at 35; SOCIAL SECURITY SOLVENCY, supra note 36, at 82–83.
\textsuperscript{145}PRESIDENT’S COMM’N TO STRENGTHEN SOC. SEC., supra note 7, at 33.
potential problems. While one may ultimately conclude that private accounts offer a better solution, ignoring the alternatives adds nothing to a balanced debate. This Article attempts to address and devise solutions to correct the flaws in both major investment schemes.

It is possible for a government administered private market plan to be structured so as to have individual accounts and various choices among alternative portfolios. In fact, such a plan may end up having as many or more choices than a system of private accounts like that recommended by the CSSS. If the government administers such accounts, the composition of the portfolios or the single portfolio will require judgments on the part of any governmental administrator. While the trustee should be insulated from politics and regulated in some fashion, the trustee or the empowering legislature will need to make a decision regarding the risk-return tradeoff (in the context of portfolio theory) and the investment policy. Such a choice is inherently inimical to an individual citizen’s degree of risk tolerance.

4. The Choice Between Passive and Active Management

The choice of the appropriate degree of risk to assume is a prelude to choice of investment strategy. The two major investment strategies are active management and passive management. Active management entails a trustee selecting investments after diligent study and comparison. Passive investment involves the mimicking of a particular index or professionally managed portfolio. This type of investing can be accomplished either by the purchase of shares in the individual investments or shares in the indexes themselves.

While both methods of portfolio management have advantages and disadvantages, passive management cannot exist without its more vigorous counterpart. The efficient operation of capital markets requires investors to evaluate the performance of companies. The individual conclusions will lead the active investor to decide whether the investment is underpriced, overpriced, or priced at its intrinsic value. The aggregate of the marketplace’s pricing conclusions and the accompanying buy, sell, and hold decisions will determine the demand and price of the security. The process of active management therefore entails great effort and cost.

Passive management, on the other hand, is a follow-the-leader approach. It assumes that some other party has done an efficient job of creating and managing a portfolio. Hence, passive investors are content to buy and sell investments in the same proportion that the index does. The

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147 Id.
148 Id. at 42, 47, 49.
149 Weiss, supra note 90, at 994.
150 In the plans outlined in the Final Report of the CSSS, however, individuals are not free to create their own portfolios. PRESIDENT’S COMM’N TO STRENGTHEN SOC. SEC., supra note 7, at 42, 47. Thus, under the first tier of the CSSS’s proposed investment structure, the government would be charged with making the same decision that it would make if a governmental investor plan were enacted. Id. See discussion infra Part V.C.5.
151 Weiss, supra note 90, at 994.
primary advantage of passive management is the reduced administrative cost. If a central government investor used this strategy, it would attract less criticism than would the active selection of the government’s investment choices.

There are a number of disadvantages associated with index investing as well. Probably the most important issue concerns the choice of the index that the fund will track. Popular choices for many investors include the well-known Dow Jones Industrial Average (“DJIA”), the Standard & Poor’s (“S&P”) 500, and the Wilshire 5000. Indeed there are hundreds, if not thousands, of indices to choose from. If passive investing is ultimately selected as the mode of investment, there will be a debate as to the breadth of the index’s exposure and its history of performance. Although it would be best to allow flexibility in the investment strategy adopted, it would be wise to make sure that the choice is consistent with portfolio theory.

Another looming issue concerns one of the possible deleterious market effects that the Social Security fund could create. The fund might be too large to manage passively.152 While the Federal Employee’s Retirement System (“FERS”) fund153 and the Thrift Savings Plan for federal employees are passively managed,154 they are substantially smaller than the Social Security trust fund.155 Some scholarship supports the belief that there is already too much passive investing in the market.156 This concern raises the specter that the private markets could become inefficient and potentially endanger the trust funds.

5. **Cost Reduction**

A trust fund operated by a single manager has a number of advantages over multiple funds because of its scale and scope. If operated efficiently, the fund could operate with lower transaction costs. This is true for a number of reasons. The trustee could buy shares in bulk, thereby paying a wholesale price, whereas individuals would pay the retail price.157 A single fund operator can also avoid the costs associated with operating over 125 million individual active accounts.158

There are a number of disadvantages as well. There is the danger that the government monopoly on the Social Security system could prove inefficient due to the absence of competition and the pressure to deliver higher returns. Despite the ability to buy blocks of financial instruments at discounts, the sheer magnitude of the demand by the trustee would serve to increase the price at which the fund could purchase the stock, thereby reducing the yield. In addition, government trustees would need to avoid

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152 Id. at 998.
155 SOCIAL SECURITY FINANCING, supra note 44, at 22.
156 Weiss, supra note 90, at 998.
157 Jones, supra note 126, at 26.
158 Id.
buying or selling too many shares too quickly lest they “move the market” and create speculative distortions or chaos.

6. **Risk Management**

One of the strongest arguments for this private market alternative is the government’s ability to serve as a risk manager. Portfolio theory cannot eliminate market risk, and when the market performs poorly, the role of the government is critical. In the foreseeable future of the current system, when cash outflows are predicted to exceed inflows, the funds will begin to pay some benefits out of the interest that has accrued on the investments. Shortly thereafter, the funds will need to begin liquidating the assets that, hopefully, have been earning healthy returns.

If the fund is forced to liquidate assets during a period when the market has dropped in value, the fund may suffer capital losses without the benefit of being able to declare the deductions available to individual taxpayers. Even if the economy is healthy, there could be a downward force exerted on future security prices as Baby Boomers liquidate other pension funds. Many of these problems not only cannot be avoided, but would also hold true in the case of individual accounts. The difference is that the government could more easily absorb market shocks and make up the losses with general revenues than could low-income individuals, who are highly dependent on their benefits.

7. **Political Interference**

Perhaps the most pernicious characteristic of a government-managed fund is the possibility of political interference and chicanery. Alan Greenspan has publicly pondered the danger that politics pose in eroding the returns on investments. The government could also interfere with corporate governance in two ways: by refusing to invest in a company unless it changes a particular corporate policy, and by exercising the voting rights attached to the common stock. Since the federal government would be the country’s single largest stock investor, its influence in the affairs of corporate governance would be enormous. This also presents the opportunity for fund managers to engage in cronyism.

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159 2001 TRUSTEES REPORT, supra note 8, at 10.
160 Id.
161 SOCIAL SECURITY FINANCING, supra note 44, at 4.
164 Nickles, supra note 3, at 100.
166 SOCIAL SECURITY FINANCING, supra note 44, at 9. When a party purchases a security on the secondary market, the issuer of that stock does not receive any money, but will benefit indirectly if demand for its shares causes its stock price to increase. A corporation benefits directly when it sells its securities in a primary offering.
167 Id.
168 Id. at 55.
169 Weiss, supra note 90, at 999–1003.
A number of measures could be implemented to protect against abuse or improper meddling by the government. First, the enabling legislation could insulate the trustee from the political process. Second, at the time of the system’s inception, the government could identify the types of investments in which the fund may not invest. For example, the legislation might prohibit investments in companies that use child labor or commit egregious environmental violations, just as some state run funds decided to divest their interests in tobacco companies against whom they were litigating. Third, the legislation could prohibit the government from exercising the voting rights of common stock. Finally, to protect against prejudicing minority stockholders, whose voting rights would be diminished, the fund could be prohibited from owning more than a specified percentage of any particular company.

C. PRIVATIZED INDIVIDUAL ACCOUNTS

1. Political Support

A Social Security plan consisting of individually funded accounts has long been considered a popular alternative to the current structure. There have been many supporters of a wide variety of these types of plans in recent years. Two different species of this type of plan, the personal security account (“PSA”) plan and the individual account (“IA”) plan, were supported by seven of the thirteen members of the 1994–1996 Social Security Advisory Council. Various plans have been supported or proposed by President Clinton, Senator Don Nickles (R-OK), Representative John Kasich (R-OH), Representative John Porter (R-IL), Representatives Jim Kolbe (R-AZ) and Charles Stenholm (D-TX), Representatives Richard Armey (R-TX) and Jim DeMint (R-SC), and the Cato Institute. President George W. Bush and the Commission to Strengthen Social Security have also proposed a plan and menu of options that would serve as the basis for such reform.

2. Defined Contribution and Defined Benefit Plans

Aside from the autonomy given to the contributor, the major difference between a private account plan and a government-managed system is the

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170 Nickles, supra note 3, at 100–01.
171 SOCIAL SECURITY FINANCING, supra note 44, at 59.
172 Id. at 62.
174 Id. at 151–53.
175 Id. at 149.
176 President Clinton, supra note 46.
177 See generally Nickles, supra note 3.
178 Olavarria-Gambi, supra note 42, at 167.
179 Solomon & Barrow, supra note 1, at 17.
182 Nickles, supra note 3, at 96; Tanner, supra note 122, at 19–20.
183 See generally PRESIDENT’S COMM’N TO STRENGTHEN SOC. SEC., supra note 7.
relationship between the benefit paid out and the taxes paid in. The
structure of the current Social Security plan is commonly described as a
“defined benefit” (“DB”) system. In such a system, the benefits are
expressed as a definite sum of money to be paid out on a periodic basis
after retirement. The alternative to a DB system is a “defined
contribution” (“DC”) system. This is the structure, or a portion of the
structure, that the Social Security plan might have if privatized individual
accounts are ultimately adopted.

The numerous proposed plans with DC structures differ greatly in
detail. They do, however, share a number of common features. Under most
such plans, payroll contributions would be directed away from the current
Social Security system into the individual’s account. The accounts are
fully funded, meaning that they will pay out benefits according to the
amount of money they contain. Unlike DB plans, there are no unfunded
liabilities since they do not promise any particular benefit. In other words,
since the system does not make promises regarding the amount of benefits,
it cannot fail to keep such promises.

There is a definite bifurcation between the two types of individual
account plans. The majority of these plans call for “partial privatization,”
while a minority set out a “fully privatized” scheme. In a partially
privatized system, only a percentage of workers’ contributions is deposited
into their personal accounts, with the remainder going into the regular
Social Security trust fund. Unfortunately, this action leaves the benefits
due from the current trust fund further underfunded than they were before
the reform. The CSSS models are examples of partially privatized plans.

In a fully privatized system, all of the workers’ payroll taxes are
deposited into their private accounts. The fully privatized plans, however,
particularly the substitutive models, create the greatest deficits because
they cordon off the original public system, thereby prohibiting further
entrants. Examples of the fully privatized models include the INA Plan, the
Super IRA plan, and the Chilean system.

3. Tiered-Benefit Structure of a Partially Privatized System

Partially privatized systems use a tiered-benefit structure, often with
two specific tiers. The first tier provides a defined, flat benefit from the

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184 Moore, supra note 55, at 347.
185 Id.
186 Id. at 348.
187 Moore, supra note 29, at 150.
188 Id. at 153.
189 Solomon & Barrow, supra note 1, at 17–19.
190 Id. at 19.
191 Olavarria-Gambi, supra note 42, at 165.
192 Solomon & Barrow, supra note 1, at 19.
193 Mesa-Lago, supra note 119, at 773 (explaining that in a substitutive model, the original system
is either shut down completely or, after a short transition period, new members are forced to join the
new system).
194 Solomon & Barrow, supra note 1, at 19.
government-operated trust fund,\textsuperscript{195} while the second tier provides a benefit based on the investment returns from the individual account.\textsuperscript{196} In many ways though, this tiered structure is not novel because retirees currently supplement their Social Security benefit with other pensions. To the extent that their Social Security benefits and other funds are insufficient for them to maintain a lifestyle above the poverty line, retirees might be eligible for Supplementary Security Income ("SSI"). Thus, the SSI welfare program serves as an additional tier.\textsuperscript{197}

The tiered nature of the payments has an important effect on the progressivity of the social insurance system. The formulaic payout of the current Social Security system, which resembles the first-tier payment of the privatized system, enables a degree of income transfer and therefore, emphasizes the goal of income adequacy. However, as the benefit is reduced in order to fund the DC portion, the partially privatized system favors the goal of equity above adequacy.\textsuperscript{198} Indeed, the creation of a fully privatized system would entail an even greater departure from Social Security’s current ideological flavor, unless an adjustment is made in the benefit formula to aid lower-income beneficiaries.

4. \textit{Choosing the Investor}

Decisions regarding the management of the individual accounts are complicated by the inherent ideological conflict posed by the scenario. On one hand, it is a paternalistic notion that forces workers to save for their retirement.\textsuperscript{199} On the other hand, a system of individual accounts trusts the workers to prudently invest the money that the system believes they could not otherwise be trusted to save if contributions were not mandatory.\textsuperscript{200} Most people agree that contributors should have some freedom to choose among a number of prudent alternative investments. This agreement, however, begs the question, “If the government and the contributors are not suitable caretakers for the nation’s retirement future, who is?”

One possible answer to the question is “employers.” Such is the case under ERISA.\textsuperscript{201} This answer, however, is not necessarily a good one. While large corporations may have the internal resources and expertise at their disposal with which to study and engage this task, many employers do not. The vast majority of businesses in this country are quite small, and many small business entrepreneurs lack the requisite financial competence to manage the retirement funds of their employees.\textsuperscript{202} Even if they were able to prudently invest the funds, they might be unable to satisfy the

\begin{footnotesize}
\begin{enumerate}
\item[195] Moore, \textit{supra} note 29, at 150.
\item[196] Id. at 150–151.
\item[197] DERTHICK, \textit{supra} note 40, at 283.
\item[198] Moore, \textit{supra} note 29, at 164.
\item[199] Id. at 158–59.
\item[200] Id.
\item[201] Weiss, \textit{supra} note 90, at 1000.
\item[202] Id. at 1000–01.
\end{enumerate}
\end{footnotesize}
complex fiduciary duties that would require them to avoid conflicts of interest.203

By a process of elimination, one of the only remaining groups capable of managing the accounts is the community of financial professionals.204 They are an intuitive choice because they already manage huge amounts of money and pension funds. Since they also stand to profit from this form of privatization, it is no surprise that they strongly support President Bush’s plans.205

As the purpose of the Social Security system is to provide some minimum benefit to millions of workers, the professional fund managers would need to be regulated. Their fiduciary duties would have to be strictly outlined. They could not be judgment proof; in the event of their mismanagement, they would have to be held liable for damages.206 Also, their fees would have to be reasonable. The law regulating mutual funds207 and the experiences of the Pension Fund Administrators in Chile (Administradoras de Fondos de Pensiones or “AFPs”) would serve as excellent starting points for the complex drafting the system would require.

5. The Role of the Individual

The legislation should address the allocation of assets, particularly in the context of portfolio theory.208 Individuals might be allowed to select from a menu of scientifically constructed portfolios.209 In this way, they could choose the portfolio that best reflects their tolerance for risk and their desire to achieve a particular return. The default choice for apathetic contributors should be the most moderate of choices. Depending on how libertarian the attitude of the system’s architects, the system might even allow individuals to create their own portfolios.210

If the individual retirement accounts were made voluntary, the most timid or apathetic individuals could choose to remain completely within the old system. A voluntary system, however, would clash with the equity principle that is inherent in Social Security as it is currently constructed.211

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203 Id. at 1001–02.
204 Id. at 1003.
206 Weiss, supra note 90, at 1011–12.
207 Id. at 1013.
208 Id.
209 Id. at 1009.
210 Id. at 1009–11. The proposed investment system in the Final Report of the CSSS does not allow investors to construct their own portfolios. PRESIDENT’S COMM’N TO STRENGTHEN SOC. SEC., supra note 7, at 42. The Commission recommends a two-tiered investment structure, which is not to be confused with a tiered benefit structure. Id. See discussion supra Part V.C.2. In “Tier I,” contributors choose their investment from the nine possible plans: five funds currently offered by the Thrift Savings Plan, three additional balanced funds, and an inflation-protected government bond fund. PRESIDENT’S COMM’N TO STRENGTHEN SOC. SEC., supra note 7, at 42, 47. Once workers have accumulated an amount of money above a particular predefined balance, they would be allowed to invest that money in a range of “Tier II” qualified funds. Id. at 42. The second-tier funds would be private-sector funds that meet important diversification, performance, and fee standards. Id.
Because the current system allows for a degree of income redistribution, it offers a higher return for low-income workers, thus serving as an incentive for higher-income workers to opt out.\textsuperscript{212} Without other changes, the ability to redistribute income would be reduced, as a disproportionate number of individuals who remain in the old system would be lower-income workers.\textsuperscript{213} It would also create a transition problem as the old system would become further underfunded.\textsuperscript{214}

If individuals are allowed to choose among fund managers that would compete for their money, the system should provide for at least some minimum level of investment education for the average worker. It is important that workers understand the basic financial concepts and terminology that would allow them to make basic decisions and comparisons. While recent studies show that the number of investors and their level of knowledge are constantly increasing,\textsuperscript{215} surveys also show that the financial knowledge of the average person is abysmally low.\textsuperscript{\footnote{Nickles, supra note 3, at 106.}} While this is no cause for shame for the individual worker, it does indicate the enormous obstacles that personal choice entails. The multitude of customers will have to be kept informed of the performance of their investments,\textsuperscript{217} given a means of readily comparing the performance of all funds, and given some limited ability to choose a different fund.

Since this type of system forces workers to bear market risk,\textsuperscript{218} it is only fair that lay contributors be given the tools with which to handle such risk. Studies have shown that women, minorities, and low-income workers tend to have less experience and knowledge about investing.\textsuperscript{219} These constituencies also tend to be more risk averse,\textsuperscript{220} possibly because they have less income and are more dependent upon their benefits. Education is one means of at least partially offsetting such risk.\textsuperscript{221} In fact, simply warning investors of the costs of switching investments could aid in preserving their investment gains.

6. \textit{The Annuitization of Individual Accounts}

\begin{enumerate}
\item \textit{In General}

Under the current system, when retirees become eligible to receive their benefits, they must file an application to begin drawing on their Social
\end{enumerate}
Security pensions. The process would be somewhat different under a privatized system. Most likely, retirees would be required to purchase annuities from insurance companies. A regular monthly sum would be paid out for the rest of the beneficiary’s life, thus eliminating longevity risk, or the possibility that retirees will outlive their funds.

While some plans mandate the annuitization of the private account, others do not. Where it is not required, there is sometimes the possibility of obtaining a programmed pension from the account administrator. To ensure that retirees can afford annuities if their accounts do not yield enough money, the government could guarantee a minimum return on their accounts. In this situation, or in the event that retirees do not annuitize their accounts and eventually run out of money, SSI could be utilized to save such retirees from poverty.

b. Equitable Complications Although unlikely, logistic, political, and legal difficulties might prompt legislators to implement a plan that does not require annuitization. In some cases, the law may require the use of a single life annuity table, requiring that all beneficiaries be treated alike, despite their individual characteristics or the actuarial generalities associated with their demographic. Although this is equal treatment, it may be inequitable due to the different average life spans of individuals of different genders and races. For example, demographic studies have shown that the life expectancies of women exceed those of men and that the life expectancies of Caucasians exceed those of African-Americans.

Both federal and state civil rights laws prohibit otherwise fair classifications based on race, because they legally constitute discrimination. Even if permitted, explaining that African-Americans should receive higher monthly benefits than Caucasians would pose a difficult political problem once the issue has been distorted through the prisms of partisan political debate. While some states allow such classifications favoring women, an awkward problem would again be presented. The insurance companies or other administrators would have to publicly explain why, ceteris paribus, a woman should receive a lower monthly benefit than a man should merely because women tend to live longer.
c. Implications for the Spouse and Family

Systems mandating annuitization are more equitable to spouses than those that omit such a requirement. Under the current Social Security system, the auxiliary benefits received by spouses are simply calculated as one-half of the insured person’s primary insurance amount (“PIA”).233 When the insured dies, the surviving spouse is entitled to receive widow or widower’s benefits.234 If the insureds die before recovering the value of their contributions, however, the unrecovered contributions are not paid to their families.

Under a plan with individual accounts and no annuitization requirement, the decedent’s designated beneficiaries estate would inherit the account funds in the form of a remainder interest.235 The value of this right would depend not only on the return on the investments in the account, but also on when a worker passes away. If the worker passes away shortly before retirement, the accumulated wealth in the funds would be near its peak. On the other hand, former workers who pass away after retirement, will have begun to draw down their accounts already, leaving less for devisees.236

Under a plan where annuitization is mandatory, workers cannot bequeath their funds to anyone. The nonworking spouse is given the option to buy into a joint and survivor annuity whereby the spouse would be...

234 Id. at § 404.335.
235 Moore, supra note 55, at 395–96. State law would govern the inheritance, and there will likely be a great deal of disparity among the states’ systems. If the federal government wishes to protect nonworking spouses, it may wish to create a uniform federal rule.
236 There is an ideological inconsistency in allowing participants in the Social Security system to make a devise of the balance in their private accounts. It undermines the insurance aspect of “social insurance.” Insurance has two fundamental characteristics: transferring of risk from an individual to a group and sharing of losses by all members of a group. The law of large numbers allows actuaries to make educated predictions regarding the probability of certain events happening to any one member within the group. By participating in the pool of funds and risks, individuals need not prepare for every risk and can thus make the best use of their scarce resources. If the group of insureds has been properly chosen, most of the participants will not suffer the risk that they are insured against. Thus, they paid their premiums as consideration for “peace of mind.” The unfortunate person who suffers the predicted problem will reap the monetary benefit of the award. Emmett J. Vaughan & Therese M. Vaughan, Fundamentals of Risk and Insurance, 19–30 (1996).

The Social Security system covers most of the workforce and will pay all eligible seniors a monthly benefit until their deaths. It deals with longevity risk, or the risk that individuals will outlive the resources that accumulated in their working years. Some contributors will die before they recoup the full amount of their contributions. On the other hand, some beneficiaries will live into old age and collect more than the amount they contributed into the system. Since there is no way of predicting an individual’s lifespan, the system shifts the risks of advanced old age and outliving one’s retirement funds to the entire group of covered workers. This is an oversimplification since there are many instances within the system that a worker pays into the system to support benefits that the worker or the worker’s family will never be eligible for.

A system where individuals who die prematurely are allowed to “take back” their money and bequeath it to their beneficiaries runs counter to the insurance concept in the Social Security system. It is true that each individual who chooses to open a voluntary account will be able to purchase an annuity that lasts until death so as to guard against a lack of funds in old age. The creation of property rights in a portion of one’s payroll contributions, however, eliminates some of the benefits of an insurance system by creating a saving system. Unlike normal savings accounts, these accounts will contain financial securities where individual investors will bear the risk of loss unless they receive guarantees from the government. The plans recommended by the CSSS explicitly state that they will not be guaranteed. President’s Comm’n to Strengthen Soc. Sec., supra note 7, at 133.
protected in the event of the working spouse’s death. Where an annuity has been purchased and the insured dies, the insurance company reaps a windfall if death occurs before the actuarially predicted life expectancy for the insured. Only where the retiree purchased an annuity with a special payback feature, which returns some of the purchase price in the event of a premature death, would the decedent be able to bequeath those funds.

7. The Means and Costs of Transition to a Privatized System

a. In General

There have been many strong arguments posited against systems of individual accounts. Chief among them is the high cost of transition. While investing a percentage of payroll taxes in a private account may yield higher returns for that investor, it does not solve the problem of the unfunded liabilities that currently exist. Redirecting a portion of the payroll tax leaves the trust funds further underfunded. There would also be little time for those who have spent most of their lives investing in the current system to accumulate sufficient funds and high returns in their new personal accounts.

Despite the high costs of changing the nature of the Social Security system, it is probable that the costs of not changing may be even greater than the transition cost. Chile, which has the most successful individual account plans in the world, has handled these transition problems relatively well. Those who changed from Chile’s original system to the new system received bonds for the amount that they had contributed to the original trust funds. Also, a minimum pension benefit was guaranteed to those who had only a limited amount of time to contribute to and earn interest on their new account.

b. Varying Treatment of Different Groups of Cohorts

If the transition to an individual account-based system was effectuated, it is very likely that different groups of cohorts would be treated differently. Older cohorts who contributed to the current Social Security system for most of their working lives would derive almost no benefit and might possibly fare worse if forced to change to the new system. It is also likely that the lobbying and financial power of this “senior power bloc” would insulate them from disadvantages. For this reason, President Bush instructed the CSSS not to change the benefit scheme for current retirees nor those over the age of 55.

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237 Moore, supra note 55, at 395.
238 Hylton, supra note 39, at 756.
239 Mesa-Lago, supra note 119, at 777.
240 Nickles, supra note 3, at 104.
241 Mesa-Lago, supra note 119, at 777.
242 Id.
243 PRESIDENT’S COMM’N TO STRENGTHEN SOC. SEC., supra note 7, at 10, 70.
The younger middle-aged group might derive some benefit from changing as they have a greater amount of time during which to participate. This group might be given a window of time during which they could choose between the old and new system, or they might be forced to move and accept a bond.

A third group is comprised of the youngest contributors, who have been paying into Social Security for only a very short time. This group might also be given a choice of whether or not to make the transition, but it seems likely that they would want to join a system that is healthier and where higher returns are probable. Prospective workers who have not yet worked nor contributed to Social Security funds should be considered a part of this group. These youngest contributors may carry the largest burden of financing the older generations’ retirement, because a portion of their payroll taxes might directly finance the unfunded liabilities. If general revenues are used to make up the short fall, they will still bear the burden indirectly, albeit less so due to the more progressive nature of the income tax.

c. Administrative Costs

Important administrative costs must also be considered. It is often argued that the competition among fund managers should drive costs down, but empirical evidence has shown the opposite to be true. The funds established for the workers in Chile incur high costs as a result of the duplication of infrastructure and aggressive advertising used to attract customers. As is true with a government-managed system, costs passed on to the worker can have an enormous impact when compounded over a period of years.

d. Auxiliary Benefits

A more socially directed cost is imposed in the form of reduced auxiliary benefits. Under the current system, the spousal benefit is calculated as one-half of the PIA. Under some of the proposed plans, however, the spousal benefit would be calculated as a percentage of the first-tier benefit, an amount lower than the current benefit. While this is equitable to single workers, it has a detrimental effect on women. Although women who have their own income are less affected, their benefits may be smaller due to the fact that women tend to earn lower

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244 CRITERIA FOR EVALUATING, supra note 69, at 40.
245 Olavarria-Gambi, supra note 42, at 175.
246 Id.
247 Mesa-Lago, supra note 119, at 784.
248 ADMINISTRATIVE COSTS, supra note 217, at 3.
250 Moore, supra note 55, at 392 (explaining that dependent children, whose benefits are also calculated based on the first-tier benefit, receive reduced benefits under the proposed system).
251 Id. at 397.
252 Id. at 394.
salaries than men. As mentioned above, dependent spouses may also be affected if the working spouse is not required to buy a joint and survivor annuity.

8. **Income Progressivity**

Changing to a new type of system might also reduce the progressivity of a system that already has several regressive elements. These elements include the uniform tax rate and the cap on the maximum taxable wage base. The CSSS has explored the possibility of raising the annually adjusted cap. Only Reform Model 3, however, contained such an option, and its enactment would likely prove rather difficult. In a system with a two-tiered benefit structure, the formulaic income transfer would only take place in the reduced first-tier benefit. The remainder of retirees’ benefits would come exclusively from the returns on their chosen investments.

This point would be rendered moot if the returns on the invested assets exceed the benefits of the income transfer that lower-income recipients currently receive. Such returns on the individual accounts, however, are not guaranteed. A solution to the problem of loss of income progressivity can be achieved with matching funds or seed money given to low-income workers. As Senator Nickles points out though, the current Social Security system is not as progressive as some claim, as low-income workers tend to begin working at an earlier age and contribute to the system for a longer period of time.

VI. **THE CHILEAN SYSTEM: A MATURE AND FULLY PRIVATIZED SYSTEM**

A. **HISTORICAL BACKGROUND**

Those who say that a funded system of personal accounts cannot possibly work need only look to Chile to realize their error. Such a system has existed in Chile since 1981, and has been extremely successful.

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254. See discussion infra Part VI.6.A.

255. **Hylton, supra note 59, at 753–54.**

256. **PRESIDENT’S COMM’N TO STRENGTHEN SOC. SEC., supra note 7, at 121 & n.44; Robert A. Rosenblatt, Options Given to Save Social Security, L.A. TIMES, at A36.** The taxable wage base against which the Social Security payroll tax could have been applied in 2001 was $80,400. **Id.** Reform Model 3 would increase the taxable wage base to $85,000. **Id.** The co-Chairmen had different feelings about this issue. Moynihan considered the increase to be a technical adjustment that was within the recommendation power of the CSSS. **Id.** Parsons thought that the increase might violate the President’s prohibition on increasing taxes as a part of the reform plan, and he sought guidance from the White House on the issue. **Id.** If Congress considers the issue, it is not clear that such an adjustment, which has the net effect of raising taxes, would be enacted. The abolition of the cap, however, would increase revenue collection and at least partially extend the solvency of the system.

257. **Hylton, supra note 59, at 749.**

258. **Moore, supra note 55, at 385.**

259. **Nickles, supra note 3, at 99.**
Hoping to capture a measure of Chile’s success, eight Latin American nations have implemented a type of privatized system. While it is true that the social, economic, and political realities in those countries are different from those in the United States, the United States may learn much from Latin America’s experiences. Every system in the region is different, and there is a veritable menu of choices from which the United States can choose.260

Chile pioneered social insurance in the Western Hemisphere. Its original system was a PAYG system, much like the one the United States has now. The Chilean system was created in 1924, before the Great Depression in 1929 and the creation of the American Social Security system in 1935.261 While the Depression and top-down political decisions were driving forces for the birth of the U.S. system,262 in Chile, the impetus for the legislation came from the violent reaction by workers after the Chilean Congress failed to implement reforms to improve their deteriorating financial condition. Thus, the Chilean movement can be described as a bottom-up or grassroots movement.

The original Chilean PAYG system263 suffered from funding problems similar to those that the U.S. system is currently experiencing. When payroll taxes failed to cover the promised benefits, they were financed with the public budget, or general revenues.264 Much like the political debates in the United States, political squabbling prevented corrective action.265 Three successive Chilean presidential regimes throughout the fifties and sixties debated reforms and made proposals, but none passed in the legislature.266 Finally, Chile’s contemporary privatized system was unilaterally imposed in 1981 under the military dictatorship of General Augusto Pinochet.267 It was not until 1990 that a democratic government formally ratified the Chilean plan,268 thereby removing the stigma on the system perceived by so many other nations.269

B. THE STRUCTURE OF THE CHILEAN SYSTEM

The current individually funded Chilean system has been described as a “second generation” system,270 as opposed to Chile’s public, U.S.-type “first generation” system. Under the architecture of a Harvard-trained economist, Jose Pinera Echenque,271 and with the advice of Nobel laureate

260 Mesa-Lago, supra note 119, at 771–75; Olavarria-Gambi, supra note 42, at 170 (stating that nations with privatized systems include Argentina, Bolivia, Columbia, El Salvador, Mexico, Peru, and Uruguay).
261 Olavarria-Gambi, supra note 42, at 168.
262 Id.
263 Id. at 168–69. The original system was the Civil Servants Security National Fund (Caja Nacional de Empleados Publicos or “CANAEMPU”).
264 Id. at 168.
265 Id. at 169.
266 Id. at 170.
267 Id.
268 Mesa-Lago, supra note 119, at 772.
269 See id. at 773.
270 Olavarria-Gambi, supra note 42, at 170.
271 Solomon & Barrow, supra note 1, at 21.
Milton Friedman.\textsuperscript{272} Chile established a fully privatized system with individually capitalized personal accounts.\textsuperscript{273}

Chilean workers pay a payroll tax of approximately 10\% plus an additional contribution depending on the investment manager that they have chosen.\textsuperscript{274} The total percentage contribution is similar to that paid in the United States. Employer contributions were wholly eliminated in Chile based on evidence that employers merely passed the burden on to workers, in the form of lower salaries, and on to consumers, in the form of higher prices.\textsuperscript{275} To offset the increased burden to the average worker, however, the government mandated that wages be increased 18\%.\textsuperscript{276}

Of greatest importance to a prospective American program is the Chilean experience in transitioning between systems. Workers had the option of remaining in the old system,\textsuperscript{277} but many chose to change to the private accounts administered by the AFPs.\textsuperscript{278} Later, new workers were forced into the new system.\textsuperscript{279} Workers received recognition bonds (\textit{bonos de reconocimiento}) in the amount of their contributions to the original system.\textsuperscript{280}

\section*{C. THE CHILEAN SYSTEM’S RESULTS}

The administration of the accounts by the AFPs has been a qualified success. People can choose among alternative investment companies,\textsuperscript{281} so workers have a greater voice in the management of their retirement investment portfolio. The Chilean government, however, regulates the investments of these portfolios, limiting the asset selection to profitable, publicly held companies and government bonds.\textsuperscript{282}

The rates of return in Chile have been extremely high. Through 1995, the funds grew at an average annual rate of 14\%.\textsuperscript{283} Another study reported that between July 1981 and August 1999, there was an 11.3\% average annual return.\textsuperscript{284} The replacement rate for the average Chilean worker is nearly 80\%,\textsuperscript{285} compared to approximately 40\% for the average U.S. worker and 53\% for the low-income U.S. worker.\textsuperscript{286} The reformed Chilean system

\begin{thebibliography}{99}
\item[272] Tanner, \textit{supra} note 122, at 20.
\item[273] Olavarria-Gambi, \textit{supra} note 42, at 171.
\item[274] \textit{Id.} at 173.
\item[275] \textit{Id.} at 174.
\item[276] \textit{Id.}
\item[277] Mesa-Lago, \textit{supra} note 119, at 773.
\item[278] Olavarria-Gambi, \textit{supra} note 42, at 171.
\item[279] Mesa-Lago, \textit{supra} note 119, at 773.
\item[280] \textit{Id.} at 776.
\item[281] Olavarria-Gambi, \textit{supra} note 42, at 171.
\item[282] Olavarria -Gambi, \textit{supra} note 42, at 171 (explaining that a fund cannot own more than a specified percentage of a single company and a single company’s equity cannot constitute more than a specified percentage of the fund’s portfolio); Tanner, \textit{supra} note 122, at 21.
\item[283] Solomon & Barrow, \textit{supra} note 1, at 22.
\item[284] Olavarria-Gambi, \textit{supra} note 42, at 171–72.
\item[285] Tanner, \textit{supra} note 122, at 20.
\end{thebibliography}
Southern California Interdisciplinary Law Journal

has yielded more than the old system for every group except orphans.\footnote{Olavarria-Gambi, supra note 42, at 172.} Additionally, Chilean workers have a remainder interest in their accounts, whereas American workers have neither a remainder interest nor any other ownership interest in their Social Security pensions.\footnote{Fleming v. Nestor, 363 U.S. 603 (1960).}

The benefits of the system have been heralded, but the costs of reform have been high. These costs are essential, as the alternative would have been disastrous.\footnote{Olavarria-Gambi, supra, note 42, at 177.} Two of the largest costs of the original system, the accelerating, regressive payroll taxes and the huge transfers from the public budget, were eliminated. Under the new system, the AFPs incur high administrative costs resulting from the intense competition for customers,\footnote{Id. at 175.} and workers bear additional administrative costs when they transfer from one fund to another. Consequently, most Latin American systems have limited the number of changes that workers are permitted to make.

The system’s design also contains structural flaws that have impaired the efficiency of the social insurance market. Simple economics suggest that the highest yielding AFPs should be the most popular, but this has not been the case.\footnote{Mesa-Lago, supra note 119, at 784–85.} There may be multiple reasons for this improper market function. First, a dearth of financial knowledge may inhibit some contributors from understanding the market. The widespread popularity of the system and the relative simplicity of the concept, however, contradict this argument. There is an inherent conflict of interest in the system, as the wages of sales representatives of the funds are based on commissions and not on the performance of the fund.\footnote{Olavarria-Gambi, supra, note 42, at 175.} As a result, high-pressure sales tactics may induce workers to choose a lower-yielding fund.

Second, it is possible that workers understand the differences in performance, but are deterred from changing systems because of the cost of transferring investments. They might recognize that the administrative costs would reduce the yield of their portfolio. If workers understand the differences in yields, and if the costs of transferring are not prohibitive, funds might be punished if their short-term returns are comparatively low for a substantial amount of time. Fickle investors would shift to the near-term, higher-yielding funds, thereby driving up the derived demand for the assets in which these AFP’s invest. The increased demand would, in turn, increase the price of those investments, thereby decreasing the yield of the AFP’s portfolios. If this were the case, the functioning of the market would keep efficient AFPs within a fairly tight range of returns.

The government’s regulations on investments have created a “herd mentality.”\footnote{Mesa-Lago, supra note 119, at 788.} The government punishes those funds whose returns are too low for a given period of time, and some funds are dissolved because of their inability to comply with the government regulations.\footnote{Olavarria-Gambi, supra note 42, at 171.} If the period
for evaluating the return on the portfolios is too short, the funds may be penalized for assuming greater risk for greater return. For example, a fund with a strategy that would yield below-market returns for a period of two to three years before achieving its goal of high growth would fail to meet strict government standards. Lengthening the evaluation period would allow funds to concentrate on long-run performance.\footnote{Mesa-Lago, supra note 119, at 788.}

D. A COMPARISON WITH SOCIAL SECURITY IN THE UNITED STATES

The differences between Latin American nations with privatized systems and United States are great. The success of the bold Chilean experiment must be viewed in the context of that nation’s geopolitical and socioeconomic profile. General Pinochet imposed Chile’s current system without a free debate by the legislature and without the input of formerly influential unions and interest groups.\footnote{Olavarria-Gambi, supra note 42, at 170.} Prior to the implementation of the new system, there was large-scale evasion of the payroll tax.\footnote{See Mesa-Lago, supra note 119, at 782-83.} Early in the life of the new system, the AFPs invested most of the funds within the country, thereby subjecting them to country risk, in violation of that which most professional investors deem prudent.\footnote{Olavarria-Gambi, supra note 42, at 175.}

The United States might not be able to finance the transition in exactly the same way Chile did. Recognition bonds would have to be distributed to those who have already contributed to the current common trust funds. The notion that American workers have a right to their contributions would require that they receive the full value of these contributions. Also, as mentioned above, a comprehensive plan would need to be implemented to decide how different groups of investors would participate in the transition. Chile and Bolivia required only one year’s worth of contributions before a worker was credited with a bond,\footnote{Mesa-Lago, supra note 119, at 777.} while other Latin American nations required contributions for a longer period, usually three or four years.\footnote{Id.} Argentina’s system was the most Draconian, requiring thirty years of prior contributions.\footnote{Id.}

Financing this type of transition would pose an enormous challenge to the federal government of the United States. The Chilean government’s non-pension surpluses and the privatization of many of its public enterprises helped to finance its social insurance deficits.\footnote{Olavarria-Gambi, supra note 42, at 177.} This measure might not be possible in the United States. The predicted surpluses in the federal budget are not certain, and the size of the unfunded liabilities is tremendous. The Bush tax cuts, the sluggish economy, and the increased military and homeland security expenditures resulting from the attack on terrorism could further aggravate this budget imbalance.
VII. THE PRESIDENT’S COMMISSION TO STRENGTHEN SOCIAL SECURITY

A. THE LIFE AND TIMES OF THE CSSS

In May 2001, President Bush announced the creation of the President’s Commission to Strengthen Social Security (“CSSS”). The CSSS was not unique in its mission of developing reform plans for the Social Security system. In the past, similar commissions were given the duty of researching and proposing reforms. Some succeeded (e.g., Greenspan Commission), while others (e.g., National Bipartisan Commission on the Future of Medicare) did not. Such commissions and committees are sometimes useful tools for politicians to create the appearance of substantive work and consideration while dodging the issues that need to be addressed.

The CSSS had a short but tumultuous life. It endured scathing criticism and existed during a time of incredibly chaotic political change both at home and abroad. When 2001 began, Republicans controlled the Presidency and both houses of Congress. While the economy and financial markets were weaker than they had been in previous years, there did not seem to be cause for serious alarm. There seemed to be a fairly receptive climate for the President to set the nation on a path towards Social Security reform.

Shortly after the birth of the CSSS, the political tumult began. In May 2001, Vermont Senator Jim Jeffords (I-VT) quit the Republican Party since he disagreed with President Bush’s policy approaches and the conservative direction that he felt the party was taking. Prior to the surprising defection, the Senate was evenly split between Republicans and Democrats, but the Republicans held control due to Vice President Cheney’s tie-breaking vote. With Jeffords’ move, the Democrats gained control of the Senate and the leadership of its committees. With the opponents of private Social Security accounts in power, President Bush would now face a new obstacle if reform legislation were brought before the 107th Congress.

The entire political agenda of the nation changed after the tragic terrorist attacks on the World Trade Center and the Pentagon on September 11, 2001. The President and Congress had to respond to new threats to homeland security, and they began a global “War on Terrorism” centered in Afghanistan. After the attacks, the U.S. economy continued to slow and financial markets faced a great deal of uncertainty. While the CSSS continued its work, it became evident that Social Security reform was being

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303 President Bush, supra note 12.
304 Debate Intensifies over Benefits and Eligibility Under Medicare, supra note 2, at A17.
pushed farther down the list of the President’s political priorities.\textsuperscript{308} In the Final Report, upon the advice of the President, the CSSS suggested that the proposals and issues be considered for at least one year before any formal legislative action is taken.\textsuperscript{309}

B. THE MEMBERS AND THEIR MISSION

The members of the CSSS were diverse in gender, race, and professional experience.\textsuperscript{310} Although the commission was comprised of eight Democrats and eight Republicans,\textsuperscript{311} to the dismay of some interested onlookers, all of the commissioners shared the President’s vision that there be some degree of privatization and individual accounts within the system.\textsuperscript{312} This ideological homogeneity is dangerous because it may have prevented the Commission from seriously considering all alternative reforms that might improve the system. On the other hand, because the 1994–1996 Social Security Advisory Council lacked unity, it fractured and produced a tripartite proposal that left the debate unsettled.\textsuperscript{313} While the CSSS also recommended three reform plans in their Final Report, the narrow scope of the Commission’s mission and the similarity of the commissioners’ ideologies produced plans that were a lot less disparate than those of the previous commission.\textsuperscript{314}

The CSSS had a specific mission statement based on the following six guiding principles:

- Modernization must not change Social Security benefits for retirees or near-retirees [age 55 or over].
- The entire Social Security surplus must be dedicated to Social Security only.
- Social Security payroll taxes must not be increased.
- Government must not invest Social Security funds in the stock market.
- Modernization must preserve Social Security’s disability and survivors components.
- Modernization must include individually controlled, voluntary personal retirement accounts, which will augment the Social Security safety net.\textsuperscript{315}

None of the commissioners were sitting members of Congress. With the exception of co-Chairman Daniel Patrick Moynihan, who is a former Senator, and co-Chairman Richard Parsons, who was tapped to become the

\textsuperscript{309} \textit{PRESIDENT’S COMM’N TO STRENGTHEN SOC. SEC.}, supra note 7, at 8; Amy Goldstein, \textit{Social Security Panel Proposes 3 Reform Plans; Cost of Changing System Is Pegged at $2 Trillion}, WASH. POST, Dec. 12, 2001, at A33.
\textsuperscript{310} Press Release, Office of the Press Secretary, supra note 50.
\textsuperscript{311} Ponnuru, supra note 305, at 22.
\textsuperscript{312} Calmes, supra note 14, at A20.
\textsuperscript{314} Goldstein, supra note 309, at A33.
\textsuperscript{315} \textit{PRESIDENT’S COMM’N TO STRENGTHEN SOC. SEC.}, supra note 7, at 10, 70.
next CEO of AOL- Time Warner, none of the other commissioners were widely known to the public.\textsuperscript{316} For this reason, these individuals did not experience the same political pressures or fallout that might have been experienced by elected officials. This provided the commission an opportunity to experiment with bold ideas of which President Bush might not otherwise have approved, and it would have been extremely difficult for the President to disagree with his own appointees once they had made these bold recommendations. This opportunity, however, was not seized. Instead, the CSSS sought the President’s advice, and the Final Report largely satisfied the Commission’s given mission.\textsuperscript{317}

C. THE INTERIM REPORT

In August 2001, the CSSS released its Interim Report.\textsuperscript{318} The report and the Commission were harshly attacked from nearly every angle. It is not surprising that an issue as important as Social Security reform generated so much media attention, commentary, and criticism. Therefore, it is important that observers understand the context and sources of comments, as there are many political and personal agendas at work. Among the most outspoken critics were liberal economists and intellectuals.\textsuperscript{319} The Commission could not even escape criticism from conservatives, as Michael Tanner of CATO Institute attacked the proposal as a “Trojan horse” that could undercut the privatization effort.

The Commission was accused of distorting the truth in order to undermine the public’s faith in government securities.\textsuperscript{320} The co-chairmen, along with fellow commissioner Thomas Saving, described the Social Security trust fund and its surplus as essentially worthless, containing no only the promises embodied by U.S. government bonds and no real wealth.\textsuperscript{321} Although the United States government may decide to use the returns on the government bonds for purposes other than Social Security,\textsuperscript{322} Treasury bonds are the safest investment in the world and are anything but worthless.\textsuperscript{323}

Oddly, it was Moynihan who helped engineer the Social Security surplus while on a prior reform commission in 1983.\textsuperscript{324} Indeed, a number of Moynihan’s important and long-time allies have criticized and abandoned him because of his work on the Commission. Two of the more

\begin{enumerate}
\item Id. at 2; Angwin & Peers, supra note 13, at B1.
\item PRESIDENT’S COMM’N TO STRENGTHEN SOC. SEC., INTERIM REPORT (August, 2001), http://www.csss.gov/reports/.
\item Clymer, supra note 31, at A14; Krugman, supra note 319, at A17.
\item Krugman, supra note 319, at A17.
\item Turner, supra note 321, at D2.
\item Greider, supra note 319, at 5.
\end{enumerate}
notable critics were former Social Security Commissioners, Robert Ball\textsuperscript{326} and Kenneth Apfel.\textsuperscript{327} Because the Commission’s skeptical view of the Social Security surplus is similar to the view of Treasury Secretary Paul O’Neill,\textsuperscript{328} Moynihan has been accused of simply advocating the agenda of the Bush administration.\textsuperscript{329} Former Commissioner Apfel went so far as to say that Moynihan’s role on the CSSS is to endorse the plan of the President.\textsuperscript{330}

D. THE FINAL REPORT

In December 2001, the CSSS released its Final Report, which contained three proposals.\textsuperscript{331} It was originally envisioned that the Commission would deliver a single recommendation, but the commissioners could not unanimously endorse a single proposal. While Democrats have criticized the CSSS for a lack of unity,\textsuperscript{332} this commission and its recommendations are far less divided than the 1994–1996 Advisory Council and the fractured conclusions of its “triple-headed monster” proposal.\textsuperscript{333} From a political perspective, it was probably in the best interest of the CSSS not rest all of its “eggs in a single basket.”

The CSSS report lays out the basic structure and details for each of its plans.\textsuperscript{334} In each of the plans, workers would be permitted to divert a portion of their payroll taxes to their private accounts.\textsuperscript{335} As a consequence of the redirection of their payroll taxes, their benefit from the traditional system would be reduced.\textsuperscript{336} In all cases, it is predicted that the return on their private accounts would exceed the amount by which their traditional benefit would be reduced.\textsuperscript{337} If the prediction proves to be correct, the total benefit would exceed the amount that the person would have been paid under the original system.\textsuperscript{338} Investment returns, however, are speculative and the CSSS has chosen not to guarantee them.\textsuperscript{339}

Reform Model 1 allows workers to divert a specified percentage, for example 2%, of their payroll taxes into private accounts.\textsuperscript{340} Their traditional Social Security benefit would then be reduced by 3.5%.\textsuperscript{341} This plan makes no other major changes to the financing of the traditional Social Security

\textsuperscript{327} Turner, supra note 321, at D2.
\textsuperscript{328} Id.
\textsuperscript{329} Id.
\textsuperscript{330} Id.
\textsuperscript{331} See generally \textit{PRESIDENT’S COMM’N TO STRENGTHEN SOC. SEC.}, supra note 7.
\textsuperscript{333} Goldstein, supra note 309, at A33.
\textsuperscript{334} \textit{PRESIDENT’S COMM’N TO STRENGTHEN SOC. SEC.}, supra note 7, at 10.
\textsuperscript{335} Id. at 90.
\textsuperscript{336} Id.
\textsuperscript{337} Id.
\textsuperscript{338} Id. at 133–35; H.R. 3535, 107th Cong. (2001) (detailing a plan proposed by House Majority Leader Richard Armey (R-TX) and Representative Jim DeMint (R-SC) which would use guarantees to make retirement investment accounts free of risk).
\textsuperscript{339} \textit{PRESIDENT’S COMM’N TO STRENGTHEN SOC. SEC.}, supra note 7, at 98.
\textsuperscript{340} Id.
system, and the important long-term solvency problems remain unsolved.\textsuperscript{342} To maintain the solvency of the system, additional revenues will be required beginning in the 2030s.\textsuperscript{343}

Reform Model 2 allows workers to contribute 4% of their payroll taxes up to a total of $1000 annually to their private accounts. The benefit from the traditional system would be reduced by 2%.\textsuperscript{\textsuperscript{344}} This plan establishes a minimum benefit for low-wage earners and provides higher benefits to surviving spouses.\textsuperscript{345} The plan reduces future benefits by linking annual adjustments to price inflation rather than wage inflation.\textsuperscript{346} Unlike the first reform model, this plan addresses the long-term solvency of the Social Security system. It provides for the transfer of federal revenue to the Trust Fund from 2025 until 2054.\textsuperscript{347} This is the only reform model of the three that produces a positive cash flow at the end of the benchmark seventy-five-year valuation period.\textsuperscript{348}

Under Reform Model 3 workers would be allowed to divert 2.5% of their payroll tax up to a total of $1000 annually to their private accounts.\textsuperscript{349} They would also be able to contribute an additional 1% of their wages to their private accounts.\textsuperscript{350} The government would use tax credits to encourage contribution by those who earn low incomes.\textsuperscript{351} The minimum benefit from the traditional system would be reduced by 2.5%.\textsuperscript{352}

The third reform model also creates a minimum benefit for low-income workers,\textsuperscript{353} and provides higher benefits for surviving spouses.\textsuperscript{354} It penalizes early retirement and reduces benefits for upper-income workers.\textsuperscript{355} It also hints at a provision, which was not included in the final version of the plan, that would increase the taxable wage base.\textsuperscript{356} This model provides for the transfer of general revenues to the Trust Fund from 2034 until 2063.\textsuperscript{357} While this model improves the long-term solvency of the system, it will still require some additional revenues during and after the seventy-five-year period.\textsuperscript{358}

Other controversial issues include the extent of freedom of investment and the ability to spend accumulated funds upon retirement.\textsuperscript{359} The first issue concerns how the money will be invested when retirees opt into the

\begin{thebibliography}{99}
\bibitem{342} Id. at 99.
\bibitem{343} Id. at 106.
\bibitem{344} Id. at 109.
\bibitem{345} Id. at 110.
\bibitem{346} Id. at 109.
\bibitem{347} Id. at 117–18.
\bibitem{348} Id. at 13, 65.
\bibitem{349} Id. at 121.
\bibitem{350} Id.
\bibitem{351} Id.
\bibitem{352} Id.
\bibitem{353} Id. at 122.
\bibitem{354} Id.
\bibitem{355} Id.
\bibitem{356} Id. at 121 & n.44.
\bibitem{357} Id. at 123.
\bibitem{358} Id. at 13.
\bibitem{359} Amy Goldstein, Panel Agrees on Options for Social Security; Proposed Private Plans Considered Politically Volatile, WASH. POST, Nov. 30, 2001, at A2.
\end{thebibliography}
voluntary account system. The three reform models of the CSSS would use what they identify as a “mixed” two-tier structure that has a central collection system and two tiers of investment choices. This system is merely a type of private account system where the government is in charge of approving a number of acceptable investment portfolios. Investors desiring to construct their own portfolios or freely invest their money are likely be disappointed by the CSSS proposals.

Once the central administrator collects and verifies all contributions, collections would be invested in “Tier I” of the investment scheme. Investors could choose from nine different funds. Five of the investment portfolios are currently offered by the Thrift Savings Plan. They are the Government Securities Investment (“G”) Fund, the Fixed Investment Index Investment (“F”) Fund, the Common Stock Index Investment (“C”) Fund, the Small Capitalization Stock Index Investment (“S”) Fund, and the International Stock Index Investment (“I”) Fund. Three balanced funds containing varying percentages of corporate stocks, corporate bonds, and government bonds would also be available. Investors preferring these options could select among conservative, medium, and growth funds for an investment that best suits their risk tolerance and income needs. Finally, the CSSS recommends the availability of an Inflation Protected Bond Fund that invests in Treasury Inflation Protected Securities (“TIPS”).

Once a worker’s private account reaches a particular threshold level, the CSSS plans would allow the investor to choose to invest the balance and additional contributions in a “Tier II” investment. It is at this point that investors will potentially be given some of the choice and investment freedom that they were originally promised by the President. The second tier of investments will consist of private sector funds that meet strict diversification, performance, concentration, and fee requirements. The CSSS did not propose the details for the Tier II system, but has set some general deadlines for the implementation of this system.

The second important issue dealing with investors’ freedom involves investors’ access to their funds upon retirement. Retirees who hope to spend their account balances freely will likely be disappointed. The CSSS has recommended that at least some portion of the account balances be taken as an annuity. A variety of annuities will be made available through the Governing Board of the system. Investors who can prove that they

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360 PRESIDENT’S COMM’N TO STRENGTHEN SOC. SEC., supra note 7, at 42.
361 Id.
362 Id.
363 Id.
364 Id. at 47.
365 Id.
366 Id. at 42.
367 Id.
368 Id.
369 Id.
370 Id.
371 Id. at 51.
372 Id.
can live free from poverty in their retirement due to the availability of other resources, may be allowed to take money from their accounts as lump-sum payments.\textsuperscript{373} The CSSS plan also recognizes the need for protecting surviving and divorced spouses.\textsuperscript{374} Thus, the plan recommends a default requirement that retired couples purchase a two-thirds joint and survivor annuity.\textsuperscript{375} In the case of divorce it requires the sharing of funds accumulated in the personal account.\textsuperscript{376}

The Final Report also addresses some important issues dealing with the administration of the new system.\textsuperscript{377} It suggests a Governing Board based on the models of either the Federal Reserve (“Fed”) Board or the Thrift Savings Plan.\textsuperscript{378} It describes alternative methods of appointment and confirmation of members,\textsuperscript{379} and briefly alludes to what some of their qualifications should be.\textsuperscript{380} The Report also suggests that the long-staggered terms of the Fed Board members may provide more effective insulation from political influences than does the term-and-appointment structure of the Thrift Savings Plan model.\textsuperscript{381}

In a related matter, the Report suggests that the Governing Board be given the right to vote the equity shares that would accumulate in Tier I and Tier II of the system.\textsuperscript{382} The rationale is that fund managers are in a key position to advance the financial interests of the investors.\textsuperscript{383} The CSSS notes that the private accounts may eventually hold so many shares of a public company that if the shares in those accounts are sterilized, minority shareholders may eventually gain control over the corporation when they would not otherwise have had a controlling interest.\textsuperscript{384} It is questionable whether such an opportunity would arise if the funds were limited in the number of shares of any one company they could hold. In spite of its recommendation, the CSSS still recognized the potential for political influence on Board members during the appointment or renewal process given the immense voting power they would yield in the corporate world once appointed.\textsuperscript{385}

E. PUBLIC REACTIONS AND POLITICS

Within the past few years, public opinion of the possible reforms for Social Security has been mixed. Two interesting and recent, but pre-September 11\textsuperscript{th}, studies revealed an interesting phenomenon. One poll

\textsuperscript{373} Id.  
\textsuperscript{374} Id. at 52–54.  
\textsuperscript{375} Id. at 54.  
\textsuperscript{376} Id. at 53.  
\textsuperscript{377} Id. at 51.  
\textsuperscript{378} Id.  
\textsuperscript{379} Id.  
\textsuperscript{380} Id.  
\textsuperscript{381} Id.  
\textsuperscript{382} Id. at 57.  
\textsuperscript{383} Id.  
\textsuperscript{384} Id.  
\textsuperscript{385} Id.
revealed that half of the people questioned were against privatization.\textsuperscript{386} Other studies have shown that many young people support the creation of individual accounts.\textsuperscript{387} Young people are faced with the lowest future returns on their investment in the Social Security system, and the President has left room in the reform plan for them to make use of private accounts. Wall Street firms and brokerage houses, which stand to benefit greatly from privatization, also approve of the President’s initiatives.\textsuperscript{388}

An increasing number of individuals and organizations may speak out against private accounts after experiencing the market slump during 2000 and 2001 and the market volatility after September 11\textsuperscript{th}. Some organizations such as the AFL-CIO have long voiced strong opposition to the privatization scheme.\textsuperscript{389}

The Democrats, who generally oppose Social Security reform, would prefer to raise the reform issue when Republicans are most vulnerable. This tactic would likely ensure the rejection of the President’s plan\textsuperscript{390} and damage the reelection prospects for Republican Senators and Representatives.\textsuperscript{391} The game of politics is critical, since the party that controls the Congress will ultimately play the greatest role in shaping the important Social Security reform legislation.

If the final recommendations of the CSSS are to be politically viable, they must be capable of surviving the political and economic quagmire. There are a number of alternative measures of fiscal sustainability that can be used to evaluate the Social Security system.\textsuperscript{392} The traditional benchmark, however, has been to evaluate whether a plan of reform or amendment achieves financial balance over a seventy-five-year period.\textsuperscript{393} Of the three reform models proposed by the CSSS, Model 2 achieves this goal,\textsuperscript{394} Model 3 makes great progress toward solvency,\textsuperscript{395} and Model 1 leaves the issue largely unresolved.\textsuperscript{396}

While such a long-term perspective minimizes the effects of day-to-day events, some critical variables have become uncertain in the aftermath of the September 11\textsuperscript{th} attacks. The CSSS continued its work through the crisis, and delivered its Final Report within several months after the attacks. It is possible that many of the short-term and medium-term budgetary figures upon which the CSSS based its conclusions have changed due to the catastrophe and the subsequent changes in government policy.

\begin{footnotes}
\item[388] Stevenson, supra note 205.
\item[389] Id.
\item[390] Id.
\item[391] Id.
\item[392] Goldstein, supra note 359, at A2.
\item[394] Id. at 65.
\item[395] Id. at 109.
\item[396] Id. at 121.
\item[397] Id. at 99.
\end{footnotes}
Within the year-long waiting period suggested by the CSSS, the prognosis for the Social Security system and other short-medium term budgetary changes are likely to become much clearer. Sadly though, the financial woes of the national social insurance will be subject to the realities of political timelines. Matters of homeland and global security have become the most important pieces of the President’s domestic agenda.\footnote{The federal government is faced with funding a global war on terrorism, implementing an effective homeland security system, and reviving a weak economy.} A tough battle lies ahead of Congress. The Democratic leadership, particularly Congressman Richard Gephart (D-MO) and Senator Tom Daschle (D-SD), has spoken out against President Bush’s proposals and the makeup of the CSSS.\footnote{With the Senate in Democratic hands after Jim Jefford’s (I-VT) split with the Republican party, the chamber stands as a major obstacle to the President’s privatization vision.} With the Senate in Democratic hands after Jim Jefford’s (I-VT) split with the Republican party, the chamber stands as a major obstacle to the President’s privatization vision. It is likely, however, that the next Congress will handle the reform issue. Congressional opinions will likely depend on party profile, which will largely depend on the perceptions that the public forms regarding the performance of the President and Congress on the issues of homeland security and the weak economy.

Eventually, it is possible that both sides in the debate will compromise and agree to combine the two major reform models, even if the result is not a theoretically harmonious one. For example, the President and Congress might agree on a two-tiered or three-tiered system combining voluntary personal accounts and a central government investor. Under such a scheme, investors might have a personal account system much like the one proposed by the CSSS. The governmental investor, which pays a base pension benefit under the CSSS plans, might also invest a portion of its trust fund in the securities markets. Only time will tell, however, how the political powerplay and compromise will finally work itself out.

VIII. CONCLUSION

The issues with which the Social Security system is grappling are immensely difficult to resolve. If the nation’s social insurance system continues along its current path, it will eventually play out one of the doomsday scenarios outlined by economists and actuaries. Thus, Social Security reform must be one of the foremost priorities of the President and Congress. For the sake of the system’s long-term health, the reforms should include a large degree of advance funding and investment in private securities. A virtual laundry list of concerns must be addressed with great haste.

Critical decisions regarding the goals of the system and role of the government must be made. Under either major free market alternative, it is

\footnote{President Bush, \textit{supra} note 28.}
\footnote{Ponnuru, \textit{supra} note 305, at 24.}
essential that the enabling legislation set up the framework of a system that is both economically and legally sound.

If the emphasis of the system is shifted to the individual, a host of new issues must be addressed. Issues such as the degree of privatization, benefit tier structure, choice of manager, and financial education of workers will be of great importance. The system will have to deal with the difficulties of transition costs and the amount of freedom that workers will have in choosing investments and spending the funds at retirement.

On the other hand, if the government is given a key role in the retirement of the populace, decisions must be made regarding the method by which the funds will be managed. In that system, the law must attempt to maximize the advantages of having a government fund (or funds), while protecting the money from such evils as political chicanery and bureaucratic inefficiency. In both major private market scenarios, both systems will have to resolve the issue of income progressivity and the need to tailor the current benefit structure to achieve long-term balance.

Great lessons stand to be learned from the systems used abroad. Sophisticated models abound in Latin America and in Europe. Multiple models of reform can be constructed within either major private market alternative, and systems can be configured to afford various degrees of freedom to the participants. The United States must conduct careful studies of each system’s costs, investment returns, and means of transition. It is of prime importance that the analysis be evenhanded and unbiased in order to achieve nonpartisan and rational compromise on the reform issue.

The key to establishing a workable solution lies in the turbulent political realm. Senator Nickles has said, “The worst thing that could happen to America’s retirement security is for policymakers to sit on their hands for another decade.” President Bush’s promise and the work of the CSSS are the first steps on the path to reform. While there are important disagreements regarding the Social Security reforms, our government leaders and representatives must remain firm in their resolve to fix the system, even if it causes short-term pain.

No matter which private market alternative is chosen, a decision must be made. Pursuit of either course, if properly undertaken, will likely be better than no choice at all. The longer the arguments last, the more the country and its leadership will begin to resemble the hypothetical fool who starves because he cannot decide between two choices for his next meal. The private market alternatives present a menu of solutions to choose from, and there is a huge economic “free lunch” to be had. Ideally, the plan will implement a variety of adjustments and a privatized system. In choosing investments, Congress must consider human capital and labor as much as they do financial capital.

399 Mesa-Lago, supra note 119, at 773.
400 Id. at 774–75.
401 Nickles, supra note 3, at 112.
402 Stevenson & Toner, supra note 47, at A13.
The nation’s representatives in Congress must be willing to look beyond the many elections that await them, and the President must be willing to act upon their bold initiative. Mere words and rhetoric about reform will not take the place of action. Political games of chicken cannot be tolerated. Since the adoption of the Constitution, the United States has never defaulted on its financial liabilities. For the sake of the nation, let’s keep it that way.

403 See GORDON, supra note 32, at 13.