

PAYING OUR OWN WAY: THE PRIVATIZATION OF THE CHILEAN SOCIAL SECURITY SYSTEM AND ITS LESSONS FOR AMERICAN REFORM

KRISTEN V. CAMPANA *

“The country needs and, unless I mistake its temper, 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.”¹

1. INTRODUCTION

To say that the American Social Security system is in crisis is a vast understatement. In fact, a survey of eighteen to thirty-four year olds revealed that while 46% believed in UFOs, only 28% thought that Social Security would pay benefits when they retire.² Many fear that the system, as it stands today, will be unable to support retired workers thirty-five years from now,³ and that the only way to ensure a financially secure retirement is through ad-

* J.D. Candidate, 1999, University of Pennsylvania Law School; B.A., 1996, Binghamton University. I would like to thank Scully and JoAnn Campana, and Kenny and Jennifer Schaefer for their continual encouragement and support, as well as the *Journal* editors for their hard work.

¹ Governor Franklin D. Roosevelt, Speech, *Campaign Address at Oglethorpe University* (May 22, 1932), in N.Y. TIMES, May 23, 1932, at 6.

² See 141 CONG. REC. S5018 (daily ed. Mar. 31, 1995) (statement of Sen. Moynihan). Although the survey overly simplifies a very complicated issue, the lack of public confidence in the present social security system is not unfounded, as discussed *infra* Section 5.

³ See 144 CONG. REC. S6004 (daily ed. June 10, 1998) (statement of Sen. Wellstone). In his January 1999 State of the Union Address, President Bill Clinton discussed his proposal to salvage Social Security, which he believes will keep it solvent until 2055. See *Saving Social Security Now and Meeting America's Challenges for the 21st Century* (visited Apr. 1, 1999) <<http://www.whitehouse.gov/wh/SOTU99/ss.html>>. For a more detailed analysis of Clinton's proposed plan, see *infra* Section 6.

ditional, independent investments made throughout an individual's lifetime.

Baby Boomers, for whom the Social Security crisis is imminent, have dealt with the uncertain future of the system largely through such independent investments.⁴ Yet, it is unclear that they have prepared for the elevated healthcare costs that result from increased lifetime longevity.⁵ Many intend to remain in the labor force well past the traditional retirement age of sixty-five, possibly due to the uncertain future of retirement benefits.⁶ Today, individuals entering the workforce must inevitably create their own portfolio of investments and individual retirement accounts ("IRAs"), as it is doubtful that Social Security will adequately provide the funds necessary to cover rising healthcare costs and other expenses.

As the system currently functions, the 15.4% of employee earnings that are contributed to Social Security trust funds are immediately disbursed to present beneficiaries. The government issues the contributing workers a promise of future payment (an IOU), which provides a low rate of return.⁷ As one commentator criticized:

The Treasury leaves IOUs that pay only about 2.2 percent – a very poor rate of return. And then when pay-back time comes, the Treasury has no way to get the money but to call for higher taxes or more borrowing. That is al-

⁴ According to a study conducted by Scudder Kemper Investments, the majority of Baby Boomers remain uncertain whether Social Security will adequately fund their retirement. See *Scudder Kemper Investments Baby Boomer Survey Identifies Major Public Policy Issues Ahead*, BUSINESS WIRE (Boston), Feb. 16, 1998, available in America Online. The poll was conducted by Dr. Christopher Hayes, Professor of Psychology and Executive Director of the National Center for Women and Retirement Research ("NCWRR") at Southampton College of Long Island University. The poll reported that 40% of over 1000 Boomers polled resign themselves to reduced benefits, while 24% do not think that they will receive any benefits at all. Only 2% believe that Social Security is the most important factor for enjoying a financially secure retirement. See *id.*

⁵ See *id.*

⁶ See *id.*

⁷ See generally Lee Anderson, *Better Than Social Security*, CHATTANOOGA FREE PRESS, May 30, 1998, at A4.

ready costing taxpayers about 15 percent of the annual federal budget.⁸

Thus, not only does Social Security face an uncertain future; it is presently an inefficient means for managing funds that could be otherwise better invested.

Social Security figures prominently in the national political agenda, and the possibilities for system reform have been hotly debated on Capitol Hill for years. In his January 1999 State of the Union Address, President Clinton set out a detailed plan for the reform of Social Security.⁹ Clinton's plan calls for the private investment of government funds for the benefit of the system. Specifically, it proposes to "commit sixty percent of the budget surplus for the next 15 years to Social Security, investing a small portion in the private sector just as any private or state government pension would do."¹⁰

Clinton's privatization scheme is not a unique approach to Social Security reform. For example, in 1997, the Advisory Council on Social Security¹¹ presented three recommendations for "restoring the long-range actuarial balance of the OASDI [Old-Age Survivors and Disability Insurance Trust Fund] program."¹²

⁸ *Id.* Anderson also notes that three counties in Texas (Galveston, Brazoria, and Matagorda) established their own privately managed system because they found a now-closed loophole allowing them to legally opt out of Social Security. The privately managed systems created benefits higher than those of the Social Security system without an immediate threat of bankruptcy. *See id.*; *see also Opting Out in Oregon*, WASH. TIMES, May 12, 1997, at A16 (discussing a vote by Oregon legislators that urges Congress to permit the use of waivers for its residents to opt out of the Social Security system).

⁹ *See* President William J. Clinton, State of the Union Address (1999), in *America Is Working Again*, N.Y. TIMES, Jan. 20, 1999, at A22.

¹⁰ *Id.*

¹¹ *See* H.R. DOC. NO. 105-72 (1997), available in 1997 OASDI Trustees Report (visited Apr. 7, 1999) <<http://www.ssa.gov/OACT/TR/TR97/trtoc.html>>. On June 9, 1994, the Secretary of Health and Human Services announced the appointment of an Advisory Council on Social Security under the provisions of Section 706 of the Social Security Act which were effective before the enactment of Public Law 103-296. This is the last Advisory Council to be appointed according to Public Law 103-296. The Council consisted of a Chair and 12 members representing the employers and employees, the self-employed, and the public. At the request of the Secretary, the Council specifically examined Social Security financing. The Council submitted its report on January 6, 1997. *See id.*

¹² *Id.*

The first proposal would maintain the current Social Security and tax structure, allocating a portion of the trust-fund assets to private equity investment managed by the federal government.¹³ The second proposal would privatize a significant portion of currently held funds by "directing 5 percentage points of each worker's contributions . . . to a 'Personal Security Account.'"¹⁴ The third proposal would uniformly reduce benefits to "levels that could be financed by the current 12.4 percent contribution rate."¹⁵ This last approach also establishes contribution benefit plans, or "Individual Accounts," for each worker, funded through an additional 1.6% mandatory contribution paid to an investment account managed by the federal government.¹⁶

Like Clinton's proposal, all three of the Advisory Committee recommendations involve some form of privatization for the Social Security System. This emphasis on privatization is a new trend in the United States and has just recently been seriously considered by the federal government.¹⁷ Much of the public seems to echo the U.S. government's interest in privatization. According to a Scudder Kemper report, "[s]ixty percent of Boomers studied believe that Social Security should be privatized."¹⁸ Despite its popularity with many groups, however, privatization is not uniformly embraced.¹⁹

This Comment contends that the U.S. Social Security system should be partially privatized. In support of this argument, it examines the Chilean privatized Social Security system and evaluates the possibility of U.S. implementation of the Chilean model. While Chile's privatization has been largely successful, its benefits

¹³ See *id.*

¹⁴ *Id.*

¹⁵ *Id.* A contribution rate is the amount each worker contributes to Social Security through payroll taxes. See *id.*

¹⁶ See *id.*

¹⁷ Scudder Kemper Investments, *supra* note 4.

¹⁸ See *id.*

¹⁹ See 20/20: *Retired and Rich* (ABC television broadcast, Nov. 28, 1997) (reporting and interviewing by John Stossel). In the report, Stossel interviews Chile's former Minister of Labor, Jose Pinera, who lectures in the United States and advocates the privatized pension system that he created in Chile in 1980. Stossel notes that the option to privatize was not being taken seriously by most legislators, and that lobbyist groups, such as the Grey Panthers, are arguing vehemently against privatization. See *id.*

have not come without costs.²⁰ Additionally, disparities between the United States' present financial and political climates, and conditions in Chile during its privatization in the 1980s, must be considered when deciding whether to follow Chile's example.²¹ Differences aside, if the United States chooses to privatize its Social Security system, an examination of the Chilean model could prove helpful. While implementation in the United States of a system identical to Chile's is probably unfeasible, the "partial privatization" approach of the Advisory Committee²² should be adhered to with certain changes added to maintain a baseline level of Social Security benefits.

2. CHILE'S POLITICAL AND ECONOMIC PROFILE BEFORE 1980

Colonial rulers developed Chile's first pension system under the Spanish Crown, but it was rather incomprehensive and unsophisticated.²³ After gaining independence from Spanish rule, the new government established limited pensions for the military in the 1820s.²⁴ Around the turn of the twentieth century, Chile created a pension system for government workers and a few very politically influential groups, such as laborers in the state-owned railroad company.²⁵ The government left the vast majority of workers without pensions until the Mexican Revolution of 1917 "spurred the labor movement in Chile and the adoption of a new Constitution."²⁶ In 1924, despite significant dissent in the Sen-

²⁰ See *infra* Section 4.2.

²¹ See *infra* Section 5. The general instability of the Chilean government, which continued with the Latin American debt crisis of the 1980s, has been cited as part of Chile's political background that helped to enable it to privatize its Social Security system. See Peter Diamond & Salvador Valdés-Prieto, *Social Security Reforms*, in *THE CHILEAN ECONOMY: POLICY LESSONS AND CHALLENGES* 257 (Barry P. Bosworth, et al. eds., 1994); Michael Alan Paskin, Note, *Privatization of Old-Age Pensions in Latin America: Lessons for Social Security Reform in the United States*, 62 *FORDHAM L. REV.* 2199, 2219 (1994) (stating that the "Latin American models, however, do not show conclusively whether privatization can work as a plan for social security reform in an industrial nation with a mature economy such as the United States").

²² See H.R. DOC. NO. 105-72, *supra* note 11.

²³ See *id.* at 268-69.

²⁴ See *id.* at 269.

²⁵ See CARMELO MESA-LAGO, *SOCIAL SECURITY IN LATIN AMERICA: PRESSURE GROUPS, STRATIFICATION, AND INEQUALITY* 23-24 (1978).

²⁶ Paskin, *supra* note 21, at 2205.

ate,²⁷ President Arturo Alessandri Palma forced the Chilean Congress to adopt laws that mandated contributions to pensions by all private firms.²⁸ The laws allowed each employer to create its own pension regime, and to continue any plans that were already in existence.²⁹ Separate social security institutions ("SSIs") were created for blue-collar and white-collar workers. Under this system, blue-collar workers typically received benefits at age fifty-five, sixty, or sixty-five (regardless of gender), while white-collar workers usually received benefits after thirty-five years of work.³⁰ Some industry-related pensions, however, were based on years of service, often correlated to the danger involved in the job.³¹ Industries created their own pension systems, but the systems were regulated and managed by governmental agencies.³²

The next wave of pension reform swept Chile in 1952, when the system appeared to be insufficient and, probably more importantly, inefficient to administer.³³ The contribution rate was very low between 1924 and 1952: 5% for blue-collar workers and 10% for white-collar workers.³⁴ Substantial surpluses accumulated and were placed in government bonds, apartment buildings, and haciendas, but these investments performed poorly.³⁵ The Great Depression brought about inflation in Chile where, in 1932, prices doubled and the real value of the government bond portfolio held by SSIs fell by 50%.³⁶ In an attempt to prevent poor investing, legislation limited SSI investment opportunities by forbidding SSIs to invest in industrial firms. Haciendas became unprofitable

²⁷ See *id.*

²⁸ See Diamond & Valdés-Prieto, *supra* note 21, at 269.

²⁹ See *id.*

³⁰ See *id.*

³¹ For example, mining only required fifteen years of work before receiving pension benefits. See *id.*

³² See CARMELO MESA-LAGO, ASCENT TO BANKRUPTCY: FINANCING SOCIAL SECURITY IN LATIN AMERICA 107-09 (1989). For example, the petroleum industry had its own pension benefit government agency that administered the funds for the particular industry workers. Thus, the benefits received by employees in different industries were entirely independent from other benefit programs. See *id.*

³³ See Diamond & Valdés-Prieto, *supra* note 21, at 270.

³⁴ See *id.* at 269.

³⁵ See *id.*

³⁶ See *id.*

due to tariff policies.³⁷ As a result, “in the period 1947-52 investment income represented only 8.67 percent of total income for the civilian SSIs.”³⁸

In 1952, the government merged all workers into a pay-as-you-go system.³⁹ While some reports suggest that the system functioned similarly to the present U.S. Social Security system,⁴⁰ the differences between the two cannot be overlooked. The reformed Chilean system of the 1950s separated the health insurance system from the pension systems and allowed blue-collar workers to receive their pensions as annuities starting at age sixty-five. It also created a uniform annuity system for white-collar workers, although they were still permitted to take the benefits after thirty-five years of service.⁴¹ Even with the changes, “the two large government-controlled SSIs obtained a rate of return much lower than that of the older, privately managed SSIs.”⁴²

3. CHILE'S PRIVATIZATION OF THE PENSION SYSTEM AND THE CREATION OF ADMINISTRADORAS DE FONDOS DE PENSIONES (“AFPS”)

In the 1970's, the Chilean system experienced yet another overhaul of its pension benefit plans.⁴³ In 1973, before the mili-

³⁷ See *id.*

³⁸ *Id.*

³⁹ See *id.* at 270.

⁴⁰ See 20/20: *Retired and Rich*, *supra* note 19.

⁴¹ See Diamond & Valdés-Prieto, *supra* note 21, at 270-71.

⁴² *Id.* at 272. Diamond and Valdés-Prieto discuss at great length the financial difficulties that the Chilean government created in its attempt to unify the pension system. “A calculation for the 1950-77 period shows that the real value of assets held increased by 804 percent for privately managed SSIs and only 57 percent for the large public SSIs.” *Id.* (quoting statistics from C. WALLICH, SAVINGS MOBILIZATION THROUGH SOCIAL SECURITY (World Bank Policy Research Working Paper No. 553, 1983)). Other problems included the fact that although the contributions were very high, almost 70% of pensions in 1979 were minimum pensions subsidized by the state. See *id.* Further, the politics of those who were in power often had a significant impact on who received pensions. This is a very common problem in pay-as-you-go systems, but when there is a very unstable government, such as in many Latin American countries, the risk becomes all-encompassing. See Paskin, *supra* note 21, at 2206. The new system did not ameliorate the problems which plagued the administration of pensions because, in the 1970s, there were still 31 separate old-age pensions in the system, the functioning of which represented 17% of Chile's gross national product (“GDP”). See *id.*

⁴³ See Paskin, *supra* note 21, at 2206.

tary coup of General Augusto Pinochet,⁴⁴ a group of economists under the Frei government diagnosed the problems of the existing system and proposed overall reforms, known as the "brick."⁴⁵ The "brick" reforms called for an innovative capitalization of the system that included:

separation of the income redistribution and insurance functions; the options of lump-sum withdrawal and annuity purchase; replacement of legislated rules by contractual rules in fund management; nonnationalized [sic] fund management organized along the lines of savings and loans associations, with investment of contributions in bonds and equities issued by the private sector; and full privatization of the selection of provider.⁴⁶

Pinochet's military coup in 1973 did not hinder these reforms. Instead, the newly empowered government followed the guidelines of the "brick," and began to implement its measures of reform during the years 1974-79.⁴⁷

More impressive and important than the actual privatization of the system under the "brick" was the restructuring of Chile's financial capacities in preparation for the new system. For the reforms to succeed, the government had to invest large amounts of money and energy.⁴⁸ Instead of transitioning through debt financing, which would have created a significant budget deficit, the government decided to build a budget surplus.⁴⁹

The Chilean budget surplus was derived from several sources. A "value added tax on consumption" created close to half of the surplus by raising general revenues.⁵⁰ Synchronizing the privati-

⁴⁴ In 1973, General Augusto Pinochet overthrew the government through a military coup. See *id.* at 2207. The military dictatorship that ensued allowed the government to overcome the pressure groups, unions, and political parties that stood in the way of real reform. See *id.*

⁴⁵ See Diamond & Valdés-Prieto, *supra* note 21, at 273. See generally CENTROS DE ESTUDIOS PUBLICOS, THE BRICK, EL LADRILLO: BASES DE LA POLITICA ECONOMICA DEL GOBIERNO MILITARIO CHILENO (Santiago, Chile).

⁴⁶ Diamond & Valdés-Prieto, *supra* note 21, at 273.

⁴⁷ See Paskin, *supra* note 21, at 2207.

⁴⁸ See: 20/20: *Retired and Rich*, *supra* note 19.

⁴⁹ See Diamond and Valdés-Prieto, *supra* note 21, at 273-74.

⁵⁰ *Id.* at 281.

zation of the social security system with other parts of the economy also funded the transition.⁵¹ The sale of state assets, shares of which were purchased by pension funds, helped to generate revenues.⁵² Reducing expenditures, borrowing, issuing domestic debt, and reducing the benefits under the old system through the adoption of a higher retirement age further assisted the production of surplus.⁵³

As soon as Chile recovered from the recession of 1975, a plan of fiscal tightening was imposed.⁵⁴ This program attempted to reduce the growth rate of public consumption (wages plus consumer purchases of goods and services) over a lengthy period of time. Pinochet's dictatorial military rule notwithstanding, the economic boom that followed the recession of the mid-'70s was necessary for the creation of a viable surplus through the aforementioned investment and sale opportunities.⁵⁵ Outside investors and the restructuring of Chile's debt helped the country to prosper and created a surplus to finance the pensions.⁵⁶

Pinochet's military control is often considered responsible for the successful implementation of this effort,⁵⁷ because it eliminated all opposition from the old Congress and political groups. Pinochet's dictatorship was able to coordinate the efforts of all the branches of government and all administrative bodies in order to execute the plans without significant conflict.⁵⁸

In addition to creating a surplus, Chile adopted uniform rules to index the pensions consistently.⁵⁹ This was a departure from the existing indexing rules, which benefited the elite and politically influential at the expense of the average citizen. Also, because the government eliminated the "years of service" requirement for civilians, all workers received their pensions at the same time, at ages sixty-five for men and sixty for women.⁶⁰ Finally, the most controversial, albeit the most important, part of the

⁵¹ See *id.*

⁵² See *id.*

⁵³ See *id.*

⁵⁴ See *id.* at 273.

⁵⁵ See *id.* at 273-74.

⁵⁶ See Jean A. Briggs, *A Political Miracle*, FORBES, May 11, 1992, at 108.

⁵⁷ See Diamond & Valdés-Prieto, *supra* note 21, at 273-74.

⁵⁸ See *id.* at 274.

⁵⁹ See *id.*

⁶⁰ See *id.*

“brick” to be implemented by statute was the privatization of all pensions.⁶¹

3.1. *Basic Structure of the Privatized Pension Program*

A number of key features of the new system helped to create a savings element as well as a personal capitalization component, which distinguished it from pay-as-you-go systems. The government listed a number of goals for its agenda, including: (1) creating a financially stable system; (2) developing a system which inspired confidence; (3) offering personal capitalization and control over personal accounts; and (4) preventing fraud and the influence of political actors capable of altering the benefits scheme.⁶²

To this end, the Chilean government in 1980, led by its Minister of Labor and Social Welfare, Dr. Jose Pinera,⁶³ created a system of pensions “based on individual capitalization of retirement accounts invested with private pension fund managers, who were called Administradoras de Fondos de Pensiones”⁶⁴ (Pension Fund Administrators) or AFPs. The Chilean AFP system covered private sector and government employees, but excluded members of the armed forces.

Under this system, a worker selects one of the heavily regulated AFPs in which to invest the mandatory 10% contribution from his or her salary.⁶⁵ Additionally, each employee must contribute about 3% to the pension fund for group life and disability

⁶¹ See Decree Law 3,500 (Chile 1980) which created the statutory framework of the privatized pension system.

⁶² See Diamond & Valdés-Prieto, *supra* note 21, at 274.

⁶³ Dr. Jose Pinera, a Harvard Ph.D. economist, was the founder of the AFP system in Chile while he served as its Minister of Labor and Social Welfare from 1978 to 1980. He later served as Minister of Mining in Chile. He is currently the President of The International Center for Pension Reform, frequently speaking in the United States and elsewhere (he was influential in privatizing other Latin American countries' pension systems) on behalf of the privatization of pensions. Dr. Pinera is actively involved in Chilean politics, representing a Chilean community in the government as well as running for president of Chile in 1993. He is the author of four books and several articles. See THE INTERNATIONAL CENTER FOR PENSION REFORM, THE CHILEAN PRIVATE PENSION SYSTEM (Santiago, Chile).

⁶⁴ Paskin, *supra* note 21, at 2207.

⁶⁵ See Tom Fenton, *Chile to Turn Social Security Over to Private Enterprise*, ASSOC. PRESS, Nov. 6, 1980 (quoting Labor Minister, Dr. Jose Pinera, as stating “The 10 percent figure will permit a worker to retire on a pension equal to his final salary.”).

insurance coverage bought by AFPs from private insurance companies.⁶⁶ On top of the mandatory 13%, a worker may invest another 10% of his or her salary as a form of voluntary savings.⁶⁷ The government withholds another 7% of income to finance medical insurance.⁶⁸ The health system is separate from the AFP, and workers may choose between private and public healthcare systems.⁶⁹ The worker's contributions are entirely tax deductible,⁷⁰ and the money invested in the AFP is taxed upon retirement withdrawal at a preferential rate.⁷¹

The pension portion of the AFP is a type of savings account belonging to the individual that "will not be taken for any other purpose than his pension, nor will it be redistributed in favor of other workers, nor revert to the state. Funds that remain in a worker's account after his death form a part of his estate."⁷² A worker's pension fund is fully portable,⁷³ so when one changes jobs there is no need to change the account. Additionally, workers may change AFPs up to four times per year.⁷⁴

Upon retirement, an individual has three options: (1) opting for programmed retirement under an AFP,⁷⁵ making regular, limited withdrawals;⁷⁶ (2) choosing to "buy an annuity from an insurance company (with provisions for beneficiaries);"⁷⁷ or (3) selecting "a combination of the two, i.e., a temporary income with

⁶⁶ THE INTERNATIONAL CENTER FOR PENSION REFORM, *supra* note 63, at 4. This insurance further provides benefits to widows and orphans as well as insurance against premature death, permanent disability, and other "accidents."

⁶⁷ *See id.* at 3.

⁶⁸ *See id.*

⁶⁹ *See id.* at 4.

⁷⁰ *See* Jose Pinera, *Chileans Unravel Social-Security Tangle*, WALL ST. J., Jan. 3, 1986, at A13.

⁷¹ *See* THE INTERNATIONAL CENTER FOR PENSION REFORM, *supra* note 63, at 4.

⁷² *Id.* Each account holder receives a passbook to keep track of his pension account. To simplify the management of the account, each passbook holder can use a computer terminal at the branch office of the AFP to calculate how much money that he/she needs to invest each month in order to retire when desired. *See* Pinera, *supra* note 70; JULIO BUSTMENTE GERALDO, *SOCIAL SECURITY REFORM IN CHILE* 5 (1992).

⁷³ *See* Pinera, *supra* note 70.

⁷⁴ *See* BUSTMENTE GERALDO, *supra* note 72, at 5.

⁷⁵ *See id.* at 7.

⁷⁶ *See* Pinera, *supra* note 70.

⁷⁷ *Id.*

a deferred annuity.⁷⁸ A fully funded pension at retirement (sixty-five for men or sixty for women) will have 70% of a worker's final salary, plus survivor's benefits.⁷⁹ Workers with enough savings to fund a pension at 50% of their salary level may take early retirement without penalty.⁸⁰ For those who do not have enough money in their accounts by retirement to buy a specified minimum annuity, general tax revenues subsidize the difference.⁸¹

As incorporated private enterprises,⁸² AFPs compete with one another in the pension fund market,⁸³ and distribute their profits among their shareholders (the account holders).⁸⁴ AFPs are diverse in their corporate structure,⁸⁵ yet have similar rates of return on the various funds due to regulations that strictly limit the types of investment vehicles the funds may utilize.⁸⁶

Some AFPs are insurance or banking conglomerates (international financial companies including Aetna, CIGNA, and Banco Santander), while others are publicly-traded corporations listed on the Chilean stock exchange.⁸⁷ These corporations may not engage in any business other than pension fund investment and administration.⁸⁸ AFPs may only withdraw 1% from the pension fund to finance its operational costs.⁸⁹ This commission⁹⁰ must be de-

⁷⁸ BUSTMENTE GERALDO, *supra* note 72, at 7.

⁷⁹ See THE INTERNATIONAL CENTER FOR PENSION REFORM, *supra* note 63, at 5.

⁸⁰ See *id.* at 5.

⁸¹ See Pinera, *supra* note 70.

⁸² See BUSTMENTE GERALDO, *supra* note 72, at 6.

⁸³ See Pinera, *supra* note 70.

⁸⁴ See BUSTMENTE GERALDO, *supra* note 72, at 6.

⁸⁵ See THE INTERNATIONAL CENTER FOR PENSION REFORM, *supra* note 63, at 8.

⁸⁶ See Saul Hansall, *The New Wave in Old-Age Pensions*, INSTITUTIONAL INVESTOR, Nov. 1992, at 77, 81; see also Paskin, *supra* note 21, at 2208 & n.76.

⁸⁷ See THE INTERNATIONAL CENTER FOR PENSION REFORM, *supra* note 63, at 8. Some AFPs are El Libertador S.A., Invierta S.A., Magister S.A., Provida S.A., Santa Maria S.A., Summa S.A., Union S.A., Aeroperu Empresa de Transporte Aereo del Peru, Agencia de Aduana Arturo Fernandez S. Y Cia. Ltda., Agencia de Aduana Diego Tobar & Cia. Ltda., Agencia de Aduana Edmundo Munoz Flores, Agencia de Aduana Eduardo Mewes Y Cia. Ltda., Banguardia S.A., Bansander S.A., Concordia S.A., Cuprum S.A., Seguridad Ltda., Planvital S.A., Qualitas S.A., and Habitat S.A. See BUSTMENTE GERALDO, *supra* note 72, at 10-12.

⁸⁸ See BUSTMENTE GERALDO, *supra* note 72, at 6.

⁸⁹ See *id.*

posited into the Central Bank as a “guarantee,” where it is invested into “instruments guaranteeing the management of resources . . . [that] also yield a profit to the AFPs.”⁹¹ This limit on withdrawals ensures that the funds do not use their revenues to unjustly enrich a company, its owners, or its employees.

A number of safeguards protect against abuse of Chile’s privatized pension system. AFPs may invest only in certain types of investment instruments.⁹² Both the instruments and the issuing agency must be diversified in order to spread the risk.⁹³ At first, the pension funds could only invest in low-risk, domestic financial instruments.⁹⁴ Now they also may invest up to “30% of their portfolios in widely owned Chilean blue-chip stocks and shares of state-owned enterprises, which the government has begun to privatize mainly through the new pension system.”⁹⁵ As of 1994, the total pension funds of US\$22.3 billion were invested in the following manner:⁹⁶

39.4% in State instruments, the margin being 45%
32.7% in stocks
6.4% in commercial bonds
12.8% in mortgage paper
5.9% in time deposits in financial institutions
2.8% others (bonds and foreign instruments)

Presently, the Chilean government is changing its policy to allow AFPs to invest more heavily in foreign instruments.⁹⁷ Interestingly, the AFPs have not pursued this option at great length yet.⁹⁸ Quite possibly, they are satisfied with the results of their domestic investing.⁹⁹ The Chilean economy has remained rela-

⁹⁰ *See id.*

⁹¹ *Id.*

⁹² *See* Pinera, *supra* note 70.

⁹³ *See id.*

⁹⁴ *See* Pinera, *supra* note 70 (indicating some other types of investments they may now pursue).

⁹⁵ *Id.*

⁹⁶ BUSTIMENTE GERALDO, *supra* note 72, at 9.

⁹⁷ *See id.*

⁹⁸ *See id.*

⁹⁹ *See* 143 CONG. REC. H672 (daily ed. Feb. 27, 1997) (address of His Excellency, Eduardo Frei, President of the Republic of Chile stating, “The

tively stable, and with disastrous examples, such as the Asian market crisis, fund managers may be wary of investing in foreign instruments. Additionally, Latin American investment opportunities are still abundant since many countries are still in the process of restructuring their debt through the privatization of infrastructure and utility projects. These investments appear to be less risky than "unknown" foreign opportunities. Also, the state guarantees many of the domestic instruments to a certain degree, so, if their value plummets, the government would be obligated to make up at least part of the difference. Whether or not the government could in fact "make up the loss" is an open question, but for the AFPs some degree of guarantee is better than none.

4. EVALUATION OF THE CHILEAN PENSION EXPERIMENT

The Chilean pension privatization system has generated a great deal of interest and emulation in Latin America; Argentina, Bolivia, Brazil, Columbia, Peru, Uruguay, and, most recently, Mexico¹⁰⁰ have all adopted similar systems. The applause has not come without some criticism, however. The privatization process is expensive, and there is some debate as to whether it should be funded through debt financing or tax increases.¹⁰¹ Tax financing is uniformly unpopular with the public, but debt financing would increase the federal deficit. In addition to the funding inquiry, a number of critics assert that allowing individuals with little experience to make investments in the volatile stock market is not only poor economic policy but also fraudulent insofar as it takes advantage of uninformed consumers.¹⁰²

amount deposited today equals 40% of GNP and is diversified in the broad investment portfolio. Profits have averaged 12.2% annually since its inception.").

¹⁰⁰ See Frida Modak, *Mito y Realidad de las Afores en AL*, EL EXCELSIOR (Mexico), June 30, 1997; see also *Social Security: U.S. Should Copy Mexico's Tentative Reform*, DALLAS MORNING NEWS: HOME FINAL ED., Dec. 14, 1995, at 37A (comparing the crisis state of the United States' Social Security system to that of pre-privatization Mexico and noting that the Social Security administration estimates "[t]he point at which Washington must start raising taxes (or cutting benefits) to keep the federal deficit from growing could arrive as early as 1999 . . .").

¹⁰¹ See 20/20: *Retired and Rich*, *supra* note 19.

¹⁰² See *id.* (depicting economists' criticism of Dr. Pinera's views on the success of the pension system).

4.1. *Advantages of the Chilean Private Pension System*

Regardless of the critics' views, the Chilean system has many advantages, including the following: (1) reducing the "incentives to underreport income or to evade the system entirely;" (2) giving workers a stake in and authority over their future; (3) creating greater equity due to the lack of differential treatment by occupation; (4) eliminating any possibility of government redistributions of the funds; and (5) providing larger retirement benefits.¹⁰³ The system has allowed "higher net wages, lower labor costs, and reduced government spending."¹⁰⁴

Advocates of the Chilean pension system note that Chileans initially voluntarily contributed to the system.¹⁰⁵ When the government first implemented the system, people elected whether or not to join; if workers chose to move into the new system, they received a "recognition bond" payable to their account upon retirement that equaled the old system.¹⁰⁶ Of the 2 million eligible workers, 1.5 million joined within the first year of the system.¹⁰⁷ By 1995, over 4.5 million workers had AFP accounts,¹⁰⁸ and approximately 740,000 of these workers had voluntary savings accounts within the system, which accounted for an additional US\$260 million in assets.¹⁰⁹ Today, more than 93% of the workers who were in the old system have transferred to the new system.¹¹⁰

The Mexican working population similarly supported a privatized system in their country in 1997.¹¹¹ Although the Mexican government does not require eligible workers to fully invest in

¹⁰³ Lewis D. Solomon & Geoffrey A. Barrow, *Privatization of Social Security: A Legal and Policy Analysis*, 5 KAN. J.L. & PUB. POL'Y 9, 21-22 (1995).

¹⁰⁴ *Id.* at 22.

¹⁰⁵ See Pinera, *supra* note 70. "The bottom line is that when given the choice, workers will vote with their money overwhelmingly for the free market— even when it comes to such sacred cows as social security." *Id.*

¹⁰⁶ *See id.*

¹⁰⁷ *See id.*

¹⁰⁸ *See id.*

¹⁰⁹ *See* THE INTERNATIONAL CENTER FOR PENSION REFORM, *supra* note 63, at 9.

¹¹⁰ *See* BUSTMENTE GERALDO, *supra* note 72, at 4. As of January 1983, all workers entering the workforce for the first time were forced to enter the privatized pension system. *See id.*

¹¹¹ *See* Jorge Zambrano Gonzalez, *Afores: Demanden que no Limitar Deducion por Aportaciones Voluntarias*, EL ECONOMISTA (Mexico), Nov. 13, 1997.

the new system until 2001, more than eight million Mexicans (73% of those eligible) switched from a pay-as-you-go system to the Afores (the Mexican equivalent of the AFP) immediately.¹¹²

In Latin America, privatized pensions have generally provided positive growth for citizens' investments. The private pensions in Latin America contain US\$130,000 billion and increase approximately US\$1,000 billion each month.¹¹³ In Chile, investment in the local economy through the privatized pensions fueled the economic boom that the country recently enjoyed. Initially, pension funds were only able to invest in local financial instruments; today, most Chilean local projects have been financed by the pensions.

In ten years, the AFPs "have accumulated more than US\$10 billion, some 30% of the nation's gross domestic product."¹¹⁴ This capital accumulation and AFP investment result from steady contributions and "very high real rates of return," that averaged 14.5% from July 1981 to July 1992.¹¹⁵ Partially as a result of the privatized pension fund investments, the overall financial standing of Chile has improved greatly. In 1996, the country experienced a GDP growth rate of 6.7% which was "driven by exports, investment, and domestic demand . . ."¹¹⁶ This followed a GDP rate of 6% between 1986 and 1994.¹¹⁷

Although Chile invests a great deal in education, social security, and infrastructure projects, the public sector budget "will register a surplus equal to 1.2% of GDP, due in large part to declining interest and social security payments."¹¹⁸ Additionally, Chile's savings rate (the highest in Latin America),¹¹⁹ in addition to its investment rate, continues to increase while annual inflation continues to fall overall.¹²⁰

¹¹² See Chris Kraul, *Mexicans Run to Private Pension Funds*, THE L.A. TIMES, Sept. 17, 1997.

¹¹³ See *Aumenta Financiamiento de AL Mediante Fondos Locales*, EL ECONOMISTA (Mexico), Sept. 30, 1997.

¹¹⁴ *Id.*

¹¹⁵ Diamond & Valdés-Prieto, *supra* note 21, at 259.

¹¹⁶ BANK OF AMERICA NT AND SA, *Country Outlooks: Chile*, WORLD INFORMATION SERVICES, Mar. 1996.

¹¹⁷ See Roberto Zahler, *The Background, Rationale, and Success of Chilean Economic Policy*, 16 LOY. L.A. INT'L & COMP. L.J. 275, 288 (1994).

¹¹⁸ BANK OF AMERICA NT AND SA, *supra* note 116.

¹¹⁹ See WALDEN COUNTRY REPORTS, *Chile*, Jan. 30, 1995.

¹²⁰ See Zahler, *supra* note 117, at 288.

The Chilean privatized pension system has benefited the average person by providing retirement benefits, but has assisted in the emerging capital market development of the country as a whole. The revenue raised as a result of the system has provided the funding to support the new infrastructure projects of Chile and has stimulated national savings and investment.¹²¹ Worker self-control over their funds represents an important part of the development of their confidence in the system, and in the government.¹²² By retirement, most workers do not have to make extra investments to support themselves. At the same time, they prepare for their future, they invest privately into the Chilean market.¹²³ The freedom of choice that the system gives to Chilean people has been invaluable to many, providing “a solid foundation for a more stable, free and prosperous society.”¹²⁴

4.2. *Disadvantages of the Privatization of Chile’s Pension System*

As beneficial as the system may sound for the Chilean population, the system has not been implemented without some very high costs. Administrative and advertising costs, competition among the AFPs, and vulnerability to the risks inherent in private market investment are just a few of the criticisms levied against a privatized pension scheme.

One of the goals of the system was to take its administration out of the hands of the government and place the control with private investment companies.¹²⁵ The effectiveness of this transfer is questionable. Even though the government only funds approximately 7%¹²⁶ of old-system pensions, the Ministry of Labor, which regulates the pensions, still receives 27.1% of the consolidated governmental budget¹²⁷ to fund the old pension system for those who chose not to enter the new system when it was first offered.¹²⁸ It seems improbable that 27.1% of the budget is actually

¹²¹ See Paskin, *supra* note 21, at 2208.

¹²² See Diamond & Valdés-Prieto, *supra* note 21, at 259.

¹²³ See *20/20: Retired and Rich*, *supra* note 19.

¹²⁴ Pinera, *supra* note 70.

¹²⁵ See *id.*

¹²⁶ See BUSTMENTE GERALDO, *supra* note 72, at 4.

¹²⁷ See THE ECONOMIST INTELLIGENCE UNIT, *EIU Country Report 4th Quarter 1997: Chile*, Oct. 30, 1997, at 14. This percentage is by far the highest in the budget and increased by 5.5% in 1998. See *id.*

¹²⁸ See *id.*

funding the prior system's pensions, because while the population has an average life expectancy of 74.6 years,¹²⁹ only 7% of the population remains on that system. It may be that the privatization does not help lower income individuals who cannot adequately contribute to their retirement.¹³⁰ This certainly would diminish the overall success of the Chilean approach.

The system's very high administrative costs for Chilean workers represents one of the most problematic drawbacks. Costs can run "as high as 30% to match similar coverage provided at about half the cost by the U.S. Social Security system."¹³¹ While the costs have not been prohibitive, they remain much higher than many other systems, including that of United States.¹³² The system has been criticized by some as being over five times as expensive as that of the United States, and perhaps the most expensive in the world.¹³³ The administration costs per effective affiliate (worker who engages in the system), while active, are estimated at US\$89.1 per year, which represents 2.94% of average taxable earnings.¹³⁴ These costs are similar to those of "very expensive government-managed systems."¹³⁵ Yet, expensive does not necessarily mean effective. Chilean administrative costs tend to compare unfavorably with other "well-run unified government-managed systems. . . ."¹³⁶

Delinquent contributions present another problem. "In 1994, the Chilean pension fund management system released information showing that 45% of their participants were delinquent in making contributions, with 28% being more than a year behind in payments."¹³⁷ This leads one to believe that without a mandatory withholding system, many people will likely spend the

¹²⁹ See *Chile, Kaleidoscope (ABC-Clio)*, Nov. 3, 1997, at 4.

¹³⁰ See Paskin, *supra* note 21.

¹³¹ Mariana Talleda Gitomer, *Privatization of Social Security*, L.A. TIMES, Feb. 21, 1996, at B8.

¹³² See *id.* ("In the U.S., just one penny of every Social Security tax dollar collected is used for administrative expenses. Overhead costs in Chile are estimated to run as high as 30 cents on the dollar.")

¹³³ See *World Bank Reveals Chilean Pension System "More Expensive than in USA"*, EL UNIVERSAL (Mexico), July 21, 1997 [hereinafter *World Bank Reveals*].

¹³⁴ See Diamond & Valdés-Prieto, *supra* note 21, at 260; see also *World Bank Reveals*, *supra* note 133 (quoting similar statistics).

¹³⁵ See Diamond & Valdés-Prieto, *supra* note 21, at 260.

¹³⁶ See *id.*

¹³⁷ Talleda Gitomer, *supra* note 131.

tory withholding system, many people will likely spend the money today rather than save for the future. Such paternalistic concerns are warranted when considering the future strain that would be placed upon the already soaring welfare expenses if people who do not make payments need assistance beyond their personal retirement plans.

The system has also been criticized for its relentless and, some argue, fraudulent advertising campaigns.¹³⁸ The money spent on sales and marketing by the AFPs in this decade equals about half of the AFPs revenue.¹³⁹ Marketing agents for each AFP take advantage of the fact that workers are permitted to transfer their funds up to four times per year. Some promoters even pay workers to transfer their accounts in order to receive their commission.¹⁴⁰ Workers are constantly approached by agents using unethical tactics in an effort to acquire customers. Employers are also guilty of questionable tactics; some press employees to sign up because some they receive kickbacks when their employees sign up.¹⁴¹ In Mexico, many of the large banks and conglomerates, which employ thousands of people, own AFPs and constantly pressure their employees to join the AFP the the company owns.¹⁴² Julio Bustamente, the principal regulator of the AFPs, points out that if the marketers are able to share their commissions with the worker by paying the worker to switch, then the commissions must be too high.¹⁴³

The questionable methods used by the AFPs to gain additional customers highlights the fact that, in reality, the AFPs yield very similar results due to the strict regulation. Thus, changes between AFP's are likely to yield very little benefit in practice.

The fluctuation of capital markets creates another problem for the Chilean AFP system. Some argue that this problem is overstated because, as a person gets closer to retirement, he or she

¹³⁸ See *20/20: Retired and Rich*, *supra* note 19.

¹³⁹ See *World Bank Reveals*, *supra* note 133.

¹⁴⁰ *Afores Request that Account Transfer Must be Done in Branch Office by Worker*, EL UNIVERSAL (Mexico), Sept. 22, 1997. In Mexico's attempt to switch over to the new privatized pension system, the government implemented a rule that all the transfers must be made in the branch of the AFP in order to "avoid the corruption, falsification and wasteful transfer of accounts that has appeared in Chile. . . ." *Id.*

¹⁴¹ See *id.*

¹⁴² See *id.*

¹⁴³ See *id.*

cially stable investments.¹⁴⁴ However, there is no insurance against an extreme downturn in the market right before a person retires.¹⁴⁵ In defense of their system, Chilean pension authorities suggest that in the event of a negative market fluctuation, workers can avoid being left without retirement funds by simply waiting until the market corrects itself to retire. This may be an unrealistic solution, depending on the magnitude of the fluctuation. Some have also suggested that the funds do not perform as well overall as the Chilean pension authorities claim. One study stated that the Chilean AFPs have been in negative figures for two years (1995-97) and that the domestic savings that were part of the plan's goals have yet to be realized.¹⁴⁶ "The Chilean reality indicates that the pensions obtained by this system are not better than the earlier ones."¹⁴⁷ Apparently, only a very narrow group of people can retire without having to depend upon some form of governmental subsidization.¹⁴⁸ Also, according to one study, it is impossible for the pensions to surpass the increase in productivity of the country that may reach a maximum of 4%.¹⁴⁹ The fact that the funds continue to be so dependent upon the financial capacity and standing of the country may be problematic in the future, as every economy inevitably experiences cyclical booms and crashes.

5. APPLICATIONS FOR UNITED STATES SOCIAL SECURITY POLICY AND REFORM

The lesson the United States can learn from the Chilean experience contains numerous complexities. The benefits appear to be great since the system has supported an emerging economy with new capital markets. The system appears to be experiencing

¹⁴⁴ See 20/20: *Retired and Rich*, *supra* note 19.

¹⁴⁵ "If a person retires during a period of stock market crisis... the amount of money received will decrease from the affected shares..." *Chile/Economy Stock Market Drop in Chile May Affect the Retired*, NOTIMEX (Santiago), Oct. 28, 1997.

¹⁴⁶ See *Afores Defraud Workers and Cost Taxpayers 300 Million Dollars in Advertising*, EL UNIVERSAL (Mexico), Aug. 7, 1997. The article about the fraudulent system is based upon statements made by a PRD deputy, Ricardo Garcia Sainz, who was also the director general of the Mexican social security system and a PRI member.

¹⁴⁷ Modak, *supra* note 100. ("La realidad chilena indica que las pensiones obtenidas por este sistema no son mejores que las anteriores.")

¹⁴⁸ See 20/20: *Retired and Rich*, *supra* note 19.

¹⁴⁹ See Modak, *supra* note 100.

overall gains, and the freedom of choice and control over personal capitalization seems invaluable. On the other hand, the system is very expensive to administer, there are ethical business practice problems with marketing the AFPs, the minimum pension appears to still be taking up a very large part of the budget, and the risk of the market crashing and injuring the system could be very real.

5.1. *The United States' Social Security System's History and Projections*

Throughout Social Security's history, one factor remains constant: costs keep rising. In 1935 President Franklin D. Roosevelt responded to the Great Depression by passing the Social Security Act, which provided millions of workers with retirement benefits.¹⁵⁰ Four years later, the benefits were extended to widows, spouses, and dependents, and the portion of the federal budget spent on Social Security was under 5%.¹⁵¹ In 1956, Eisenhower mandated essentially universal coverage, added disability insurance, and lowered the eligibility age of women from sixty-five to sixty-two. The portion of the federal budget then spent on Social Security payments was just under 10%.¹⁵² In 1965, Lyndon Johnson created Medicare, the first of the Baby Boomers entered the labor force, and the social insurance portion of the federal budget rose to just under 20%.¹⁵³ Inflation outpaced wages in the 1970s, which resulted in a significant drain on the Social Security trust fund. In 1983, Ronald Reagan's reforms were implemented to guarantee the program's existence for seventy-five years.¹⁵⁴ Nonetheless, in 1994, the Social Security Trustees predicted that the trust fund would be completely drained by 2029.¹⁵⁵ Today, more

¹⁵⁰ See H.R. DOC. NO. 105-72, *supra* note 11.

¹⁵¹ See Robert J. Samuelson, *Social Security: A Program's Rise*, NEWSWEEK, Jan. 20, 1997.

¹⁵² See *id.*

¹⁵³ See *id.*

¹⁵⁴ See *id.*; see also CONGRESSIONAL QUARTERLY INC., SOCIAL SECURITY AND RETIREMENT: PRIVATE GOALS, PUBLIC POLICY (1983) (quoting Representative Conable, who stated, "It may not be a work of art, but it is an artful work . . . It will do what it was supposed to do. . . It will save the nation's basic social insurance system from imminent disaster.").

¹⁵⁵ See H.R. DOC. NO. 105-72, *supra* note 11.

than 20% of the federal budget is spent on Social Security payments.¹⁵⁶

With the rising costs of Social Security, why is it that the increased spending is leading the fund into depletion? It appears that the answer lies in the fundamental structure of the system which has grown too large to support itself. A general explanation of the system is worth advancing. The Social Security and Medicare taxes that a worker pays are divided among several trust funds. There are two Social Security trust funds: the Federal Old-Age and Survivor's Insurance ("OASI") Trust Fund that is used to pay for retirement and survivor's benefits, and the Federal Disability Insurance ("DI") Trust Fund that pays benefits to disabled people and their families.¹⁵⁷ There are also two Medicare trust funds that include the Federal Hospital Insurance ("HI") Trust Fund that pays for the services covered under the hospital provisions of Medicare, and the Federal Supplementary Medical Insurance ("SMI") Trust Fund that covers the medical insurance provisions of Medicare.¹⁵⁸ The 7.65% that is deducted from a worker's income is allocated to each of the funds in the following manner: 5.35% to OASI, .85% to DI, and 1.45% to HI.¹⁵⁹ Social Security taxes are not used to fund SMI, which is funded by the General Fund of the Treasury and by premiums paid by enrollees.¹⁶⁰

The Board of Trustees of OASDI, consisting of the Secretary of Treasury, Secretary of Labor, Secretary of Health and Human Services, and the Commissioner of Social Security, regulates the trust funds.¹⁶¹ At first, the fund was a pay-as-you-go system,¹⁶² but in 1983, the program implemented a "partial reserve" system to save more money than it paid out to build up reserves to maintain the system.¹⁶³ As a result of the 1983 reforms, the government deposits Social Security tax revenues into the trust funds, and any money not used to pay benefits is invested into U.S. government

¹⁵⁶ See Samuelson, *Social Security: A Program's Rise*, *supra* note 151.

¹⁵⁷ See H.R. DOC. NO. 105-72, *supra* note 11.

¹⁵⁸ See *id.*

¹⁵⁹ See *id.*

¹⁶⁰ See *id.*

¹⁶¹ See *id.*

¹⁶² See 20/20: *Retired and Rich*, *supra* note 19 (critiquing the United States' system, Dr. Jose Pina stated that the main problem with our system was that it was a pay-as-you-go system).

¹⁶³ See CONGRESSIONAL QUARTERLY INC., *supra* note 154, at 68-69.

bonds, so as to build a reserve.¹⁶⁴ These investments yield a substantial amount of interest, \$38.7 billion dollars in 1996, representing “an effective annual interest rate of 7.6%.”¹⁶⁵

Although many often assume that the government used the Social Security funds’ money for other government projects,¹⁶⁶ the present Social Security administration insists that the rumor is false and instead due to confusion over the trust fund investment mechanisms.¹⁶⁷ The government borrows money from the Social Security fund and then pays back the funds with interest at only 2.2%. Considering how long it probably takes to pay back the amount borrowed, the interest most likely does not even come close to making up the return that the fund should receive. The problem is “when we [the government] take \$100 billion a year out of Social Security and put it into debt, then, of course, when the time comes for that debt to have to be repaid, we have to do something quite different”¹⁶⁸ than borrowing again from Social Security to pay its own debt back.

5.2. *The United States’ Social Security Crisis*

No matter what the Social Security Administration contends about the use of the funds, or why the large interest revenues disappear, one thing is certain and cannot be denied: Social Security is dying. The techniques implemented over the years to salvage the Social Security system are nothing more than life-support.

According to the 1997 OASDI Trustees Report, the projections for the trust funds are increasingly dismal.¹⁶⁹ The Trustees conducted their investigation under three sets of cost assump-

¹⁶⁴ See H.R. DOC. NO. 105-72, *supra* note 11.

¹⁶⁵ *Id.*

¹⁶⁶ See 20/20: *Retired and Rich*, *supra* note 19 (Reporter John Stossel stated, “Congress takes every penny you put in and spends it now, paying off today’s retirees. Then they spend whatever’s left over covering other government promises- welfare farm supports, whatever.”).

¹⁶⁷ See *id.* When Social Security invests in government bonds, the government uses that money for other purposes. The Social Security Administration claims that the government always “makes good on its obligations” and pays the trust fund back with interest. *Id.*

¹⁶⁸ 144 CONG. REC. S2152 (daily ed. Mar. 18, 1998) (statement of Sen. Thomas).

¹⁶⁹ See H.R. DOC. NO. 105-72, *supra* note 11.

tions: low, intermediate, and high.¹⁷⁰ The major findings of the report are grouped into short-range results (i.e., the next ten years) and long-range results (i.e., the next seventy-five years).¹⁷¹

“The combined OASI and DI Trust Funds, as well as each fund separately, are adequately financed and meet the short-range test for financial adequacy.”¹⁷² Both funds’ assets are expected to rise rapidly in the next ten years, although it is predicted that the DI fund’s assets relative to annual expenditures will begin to decline as early as 2003.¹⁷³ The combined assets of the funds will likely increase from \$567 billion at the end of the 1996 to \$1,459 billion at the beginning of 2006.¹⁷⁴

The results for the long-range projections change radically after the ten-year period. On a combined and an individual basis, the OASI and DI Trust Funds are “not ‘in close actuarial balance’ over the next 75 years.”¹⁷⁵ The report further noted that,

With the retirement of the “baby-boom” generation starting in about 2010, OASDI costs will increase rapidly relative to the taxable earnings of workers. By the end of the 75-year projection period, the OASDI cost rate is estimated to reach 19.2 percent under the intermediate assumptions, resulting in an annual deficit of about 5.9 percent. Annual tax revenue would be sufficient to cover only about 2/3 of annual expenditures at the end of the 75-year period. The cost of the OASDI program is estimated to rise from its current level of 4.7 percent of gross domestic product (GDP) to 6.7 percent of GDP . . . and the annual deficit is estimated to be 2.1 percent of GDP at the end of the 75-year projection period.¹⁷⁶

¹⁷⁰ See *id.* The Administration has not specified exactly how these costs are determined, but for analysis purposes, this paper depends upon the same intermediate cost assumptions as the Administration does.

¹⁷¹ See *id.*

¹⁷² *Id.*

¹⁷³ See *id.*

¹⁷⁴ See *id.*

¹⁷⁵ *Id.*

¹⁷⁶ *Id.*

The report suggests that the combination of people having longer life expectancies, the retirement of the Baby-Boomers, and the too-late decision to increase the revenue reservoir has left Social Security powerless to sustain its beneficiaries.¹⁷⁷ “For years, there were more than 40 workers for every Social Security recipient, but now there are just three workers paying for each retiree.”¹⁷⁸ By the time most middle-aged workers retire, there will be only two workers paying for each recipient.¹⁷⁹ According to the Social Security administration’s “Highlights of Social Security Data” for November 1998, 44,211,900 people received Social Security benefits, which is an increase of 269,400 or 0.6% since November 1997.¹⁸⁰ Benefits paid out from the Social Security Trust Funds in November 1998 totaled \$31.3 billion, with average monthly benefits for November 1998 at \$770 for retired workers.¹⁸¹

5.3. *Answers for the United States*

The Social Security System must undergo a drastic reform. Some of the possibilities include different forms of privatization,¹⁸² adjusting the consumer price index to match the annual cost-of-living increase, raising the taxes of wealthier recipients, and increasing the benefit eligibility age to parallel higher life expectancies.¹⁸³

Some politicians are attempting to convince the public that the “balanced budget” agreement will be the answer to saving Social Security, since it will generate revenues that may be invested into the trust funds.¹⁸⁴ During President Clinton’s State of the Union Address in January 1999, he proudly announced that he and Congress had finally balanced the budget “[f]or the first time

¹⁷⁷ See *id.*

¹⁷⁸ 20/20: *Retired and Rich*, *supra* note 19.

¹⁷⁹ See *id.*

¹⁸⁰ See Social Security Administration, *Highlights of Social Security Data* (last modified Nov. 1998) <<http://www.socialsecurity.gov>>.

¹⁸¹ See *id.*

¹⁸² See *infra* section 1, introduction, discussing the privatization recommendations of the OASDI Trustees.

¹⁸³ See Evan Thomas & Rich Thomas, *Social Insecurity*, NEWSWEEK, Jan. 20, 1997, at 20.

¹⁸⁴ See Robert J. Samuelson, *Balancing Act*, NEWSWEEK, Aug. 11, 1997, at 24.

in three decades . . . [f]rom a deficit of \$290 billion in 1992, we had a surplus of \$70 billion last year. And now we are on course for budget surpluses for the next 25 years."¹⁸⁵ But the skepticism about the balanced budget plan itself casts a large shadow of doubt over its ability to fund Social Security.¹⁸⁶ Also, questions arise as to where the balanced budget funding came from, and whether it might have come from the surpluses generated from Social Security itself.¹⁸⁷

The other aforementioned options, excluding privatization, are, again, characteristic temporary "band-aids" that the United States government places upon Social Security. The consumer price index ("CPI") adjustment in benefits results in the over-compensation of recipients, since the adjustment overestimates the cost of living expenditure by 1.1%.¹⁸⁸ Decreasing Social Security benefits also is not a realistic option. Moreover, decreasing benefits is unfair because it affects the oldest beneficiaries, who are the least able to protect themselves and plan for the futures without the guarantee of Social Security.¹⁸⁹ Also, increasing the age at which people should receive Social Security assumes that people are living longer, and, therefore, they should work longer. What is ignored is that with longer life-spans comes a greater like-

¹⁸⁵ President William J. Clinton, *supra* note 9, at A22.

¹⁸⁶ See Samuelson, *Balancing Act*, *supra* note 184. Samuelson suggests that the balanced budget agreement is completely unrealistic and is solely a result of a strong economy. See *id.* The guidelines are not strict and, therefore, will likely not be adhered to in the probable event that the economy encounters a recession. See *id.*; see also Joe Klein, *Pretty Close to Awful*, NEWSWEEK, Sept. 16, 1996, at 51 (quoting Nebraska Senator Bob Kerry of the Kerry-Danforth Commission who, in noting that the possible balanced budget schemes of 1996 had \$60 to \$80 billion in unspecified discretionary spending cuts, stated, "To do it, you're going to have to cut the space station, Energy, a lot of other things we're never gonna do.").

¹⁸⁷ See William G. Dauster, *Protecting Social Security and Medicare*, 33 HARV. J. ON LEGIS. 461, 479-80 (1996) (explaining that "the availability of the Social Security surpluses makes the unified budget deficit smaller than it otherwise would be. Thus, some accuse policy-makers of using Social Security surpluses to hide the true size of the budget deficit.").

¹⁸⁸ See Thomas & Thomas, *supra* note 183. A commission of economic experts in December 1996 found that the CPI overstates the actual annual cost-of-living increase by 1.1%. See *id.* New York's Senior Senator Daniel Patrick Moynihan has recommended that the United States decrease the CPI, to which all government benefits are tied, by this 1.1% to match the actual cost-of-living. See *id.*

¹⁸⁹ See 141 CONG. REC. S5018 (daily ed. Mar. 31, 1995) (statement of Sen. Moynihan).

likelihood of long-term illness, which also costs a great deal of money. Although it is desirable to encourage the elderly to continue working so that the funds are not depleted as quickly,¹⁹⁰ the resulting significant age increase would not only be unpopular, but would eliminate the concept of retirement because it inherently expects workers to work until they die. Raising the taxes of the wealthy to pay for Social Security is a possibility, but allowing the rich young to pay for the elderly poor creates a welfare state with few incentives to work until retirement for either class.

5.4. *President Clinton's Plan to Save Social Security*

In his January 1999 State of the Union Address, President Clinton set out a plan of Social Security reform which included partial privatization of the funds. The plan consists of the following elements:

1. Transfer 62% of the \$4.4 trillion projected budget surpluses over the next 15 years to the Social Security System. It is planned that this will total over \$2.7 trillion;¹⁹¹
2. Invest \$700 billion of this \$2.7 trillion, into the stock market;¹⁹²
3. Reserve 15% of the surplus, which totals \$650 billion, to assist the Medicare system;¹⁹³
4. Devote 11% of the surplus, which will likely total \$500 billion, to voluntary government-subsidized retirement accounts;¹⁹⁴ and
5. Use \$2 trillion of the surplus during the next fifteen years to resuscitate Social Security by reducing the national debt.¹⁹⁵

At first glance, the plan sounds promising, and indeed, is a step in the right direction. However, the program suffers from very crucial flaws that, if not addressed, could thrust the Social

¹⁹⁰ See Jonathan Barry Forman, *Reforming Social Security to Encourage the Elderly to Work*, 9 STAN. L. & POL'Y REV. 289 (1998).

¹⁹¹ See Michael M. Weinstein, *Clinton's Plan for Social Security Has Its Backers*, N.Y. TIMES, Jan. 21, 1999, at A21.

¹⁹² See *id.*

¹⁹³ See James Bennett, *Unbowed, Clinton Presses Social Security Plan*, N.Y. TIMES, JAN. 20, 1999, at A20.

¹⁹⁴ See *id.*

¹⁹⁵ See Richard W. Stevenson, *Clinton Social Security Plan Runs into Opposition*, N.Y. TIMES, Jan. 20, 1999, at A19.

Security system back into jeopardy, possibly in an even more dire situation than it presently faces.

5.4.1. *Possible Problems with the Clinton Social Security Reforms*

One may first question exactly where this budget surplus is coming from. As noted before, it is possible that the surplus actually comes from the funds of Social Security and is replaced with IOUs from the government. "Notwithstanding the clear intention of Congress to exclude Social Security from the budget, the President's budget regularly includes Social Security balances in its most prominent displays of the deficit."¹⁹⁶ Also, under Section 710 of the Social Security Act, receipts and disbursements of the Medicare HI Trust Fund should not be included in either the presidential or the congressional budgets after the 1993 fiscal year.¹⁹⁷ Yet Medicare has often appeared in deficit calculations and in total budget descriptions despite this requirement.¹⁹⁸ Even if the surplus is not from the maneuvering of the trust funds, to project a surplus for the next fifteen years assumes too much. Michael J. Boskin, chief economist to President Bush, called Clinton's plan "politically naïve," stating that "Congress . . . will simply not stand by and let huge surpluses accumulate without spending them."¹⁹⁹ The fact that it has taken thirty years to balance the budget alone is testimony to the difficulty of this task.

Assuming that the surplus materializes, how will the government proceed in the stock market? This raises three problems: (1) volatility of the market and its impact on the government's ability to pay benefits in the face of a market crash; (2) conflict of interest with the companies, part of which the government will now own; and (3) proper insulation from Congressional meddling with the funds.

Those concerned about the volatility of the stock market need not be concerned about benefits based on the bull or bear market, as the benefits will still be determined by lifelong earnings.²⁰⁰ Yet

¹⁹⁶ Dauster, *supra* note 187, at 495 n.166 (citing OFFICE OF MANAGEMENT & BUDGET, BUDGET OF THE U.S. GOVERNMENT 15 (1996)).

¹⁹⁷ *See id.* at 495.

¹⁹⁸ *See id.* at 502.

¹⁹⁹ Weinstein, *supra* note 191.

²⁰⁰ *See id.*

this raises the question of how exactly the government will pay these benefits if the market crashes, which, it may at some point. The plan assumes a 6.75% average annual return on its portfolio, which is equivalent to the historical return from 1959-96.²⁰¹ The investments would generate 3.8% higher return than average return on the Treasury bonds in which the trust fund is now invested.²⁰² The plan makes perfect sense, unless the surplus does not materialize soon enough and the market crashes early. Once the money is invested for a few years, and if the average return does, in fact, reach 6.75%, the fund could weather a decline for a short period.

Of greater import is the government's new financial interest in the companies in which it will invest. Texas Republican Representative Bill Archer, who is chairman of the House Ways and Means Committee, complained, "[G]overnment-controlled investment in markets is contrary to free enterprise and it will open the doors to all kinds of mischief involving government dictates, favoritism and cronyism."²⁰³ For example, some note the clear possibility of a conflict between the government litigating a case against a company, while it owns stock in that company via Social Security investments.²⁰⁴

Issues such as how the government will proceed in proxy matters, including mergers and acquisitions and executive compensation, also raise concerns.²⁰⁵ The Fund's ownership of approximately 4 to 5% of the value of Wall Street shares²⁰⁶ may subject the government to increased lobbying, causing it to buy shares in environmentally-friendly or special interest companies once one has become a potential shareholder. However, these companies may not yield the anticipated 6.75% return.

The government must insulate itself from congressional meddling with the funds²⁰⁷ and invest in index or mutual funds that

²⁰¹ See Stevenson, *supra* note 195. The White House did not include the years 1997-98 in determining this average, due to the unusual rise in the stock market. See *id.*

²⁰² See *id.*

²⁰³ *Id.*

²⁰⁴ See *id.*; Gretchen Morgenson, *Wall Street Not Exactly Bullish on Plan to Aid Social Security*, N.Y. TIMES, Jan. 20, 1999, at A19.

²⁰⁵ See *id.*

²⁰⁶ See Weinstein, *supra* note 191.

²⁰⁷ See David E. Rosenbaum, *Greenspan Sees Harm in Proposal*, N.Y. TIMES Jan. 21, 1999, at A1, A19 (quoting Federal Reserve Board Chairman, Alan

track the historical average. If Clinton's plan succeeds, government involvement in companies will not be a problem because it will not own a large enough stake to control any corporation. Of course, exercising control over Congress is difficult, and Clinton has yet to explain how the "independent" board would be selected and monitored.

In addition, commentators have criticized President Clinton's proposal for the private Universal Savings Accounts ("USA").²⁰⁸ Under the USA program, each worker would receive a flat sum to open an account (for example, \$100).²⁰⁹ The worker would then have the option of contributing to his or her account.²¹⁰ The government would match these personal contributions in part, perhaps in the form of a tax credit.²¹¹

Criticism of Clinton's USA plan centers on the origin of the funds to set up the accounts. Many also question the public's inclination to contribute to such accounts, especially if the subsidy is given in the form of an abstract tax cut that might be almost meaningless to poorer workers. The plan may fall victim to the same savings aversion that the Chilean system suffered from—people would rather spend today than save for tomorrow.

It is difficult to predict whether the lack of guidelines would render the USA accounts useless. If the government matches workers' contributions with meaningful cash contributions, one with a return that would exceed more than the average savings account (such as a mutual fund or index), the account system could be a step in the right direction.

The Clinton Administration proposal provokes a necessary debate on the issue of privatization. Although such a dialogue is desperately needed, concerns surrounding the vast assumptions upon which the program rests remain. For Clinton's proposal to succeed, a surplus must materialize, Congress must not interfere, people must want to contribute, the market must not crash, and an independent board must be set up and properly monitored. This leaves aside the congressional deadlocks that will inevitably ensue regarding implementation.

Greenspan, as stating, "I do not believe that it is politically feasible to insulate such huge funds from government direction.")

²⁰⁸ See Bennett, *supra* note 193.

²⁰⁹ See *id.*

²¹⁰ See *id.*

²¹¹ See *id.*

6. POSSIBLE APPLICATIONS OF THE CHILEAN AFPs TO THE UNITED STATES' SOCIAL SECURITY SYSTEM

The United States clearly takes the projections of the 1991 OASDI Trustees Report seriously, recognizing the need for change. Partial privatization might be just the right makeover mechanism.

Clinton's scheme for partial privatization makes an analysis of the implementation of a system mirroring Chile's prudent. In Chile, privatization appears to have been a positive experience. Prior to privatization, the country was in a state of political upheaval. Chilean citizens never knew where their money would end up from one regime to the next, and the country's overall development lagged. Pinochet's military takeover offered an opportunity for an easy transition because of the dictator's totalitarian control over the Chilean Congress. The privatization of other industries paved the way for pension reform. The government was able to restructure the debt of the country, allowing the AFPs to invest in the debt instruments and the infrastructure project sales. The two sides of the transactions supported each other.

The United States' ability to implement such a system is questionable for a number of reasons. First, the United States is not similarly situated to Chile either politically or economically. Politically, the United States must contend with a partisan Congress. Its two party political process, though the foundation of our democratic society, undermines many efforts at reform that might prove beneficial to the country.²¹² Public support plays an extremely significant role in Social Security reform. The existing program is very popular,²¹³ and many politicians are reluctant to risk political ramifications from powerful lobbyist groups such as the AARP and the Grey Panthers.²¹⁴

As mentioned in Section 1, Baby Boomers have accepted the fate of Social Security and have prepared for "individual security."²¹⁵ The Chilean government dealt with similar resignation and resistance by making the switch to privatization optional. Those who were already receiving benefits were allowed to con-

²¹² See Thomas & Thomas, *supra* note 183.

²¹³ See *id.*

²¹⁴ See *20/20: Retired and Rich*, *supra* note 19.

²¹⁵ See *infra* Section 1.

tinue to do so under the old program.²¹⁶ Those who chose to change over were given a coupon that represented the amount of money that they had already contributed to the existing system.²¹⁷ This approach allowed presently retired people to continue to receive their benefits under OASDI. Since those who "cash-out" receive only a coupon, there should still be enough money in the system to support those who are now retired. Yet, whether there will be enough money left in the system to redeem those coupons when the time comes remains an open question.

Economically, the United States is in a much different position than Chile, especially the Chile of 1980. Like most of the countries that have privatized, including Argentina, Mexico, Hungary and, now, Poland, Chile is a third world country.²¹⁸ This suggests that the underdeveloped nature of third world countries may be an important factor in privatization. The fiscal tightening required to create a budgetary surplus, including borrowing, tax cuts, and assets sales, may not be realistic in a mature industrial economy, like that of the United States.

U.S. public sentiment against increases in the federal deficit would make borrowing extremely unpopular. Today, Chile faces the problem of its "deficit in invisibles," which is expected to produce a current account deficit of \$4.3 billion in 1998 and grow to "a worrying \$5.9 billion (6% of GDP) in 1999."²¹⁹ The United States' 1998 current account balance deficit is estimated at 2% of GDP.²²⁰ The borrowing that might be necessary to fund full privatization would entrench the country in further debt and increase our already formidable public external debt of \$1,132 billion in 1996.²²¹ Despite the commitment to a balanced budget and the expectation that "the deficit [will] fall over time in both nominal terms and as a share of GDP, the federal government will still be running a deficit in 2002."²²² Considering that the

²¹⁶ See Diamond & Valdés-Prieto, *supra* note 21, at 275.

²¹⁷ See *id.*

²¹⁸ See 20/20: *Retired and Rich*, *supra* note 19.

²¹⁹ THE ECONOMIST INTELLIGENCE UNIT, CROSSBORDER MONITOR: CHILE, Jan. 7, 1998.

²²⁰ See THE ECONOMIST INTELLIGENCE UNIT, COUNTRY FORECAST: UNITED STATES, July 31, 1997.

²²¹ See *id.*

²²² THE ECONOMIST INTELLIGENCE UNIT, CROSSBORDER MONITOR: USA, May 7, 1997.

OASDI funds are expected to start depleting in 2006,²²³ balancing the budget only after 2002 seems to be to little too late.

Additionally, the United States is disinclined to privatize its infrastructure. Some suggest that the success of the privatization of the Chilean pension system had little to do with the privatization of *just* the pension system. The private savings of individuals had little to do with the internal savings of the country; the real reason for the economic boom in the country was the liberalization of economic policy.²²⁴

The United States is not in a period of economic transition. There is no movement towards a liberalization of its economic policy. The Chilean transition was financed in a manner that the United States probably could not afford. Because of its closed economic structure, Chile was able to restrict its activity significantly. The United States' position as an international market would likely prohibit adoption of a similar privatized system.

Efforts to entirely eliminate the OASDI Trust Funds will probably prove to be both unpopular and economically unrealistic. However, it is possible that partial privatization of the United States Social Security program could be beneficial. The OASDI Advisory Council has suggested three sets of recommendations to restore the long-range actuarial balance of the OASDI system.²²⁵ The first approach involves maintaining the current tax and benefits structure while investing a small portion of the trust fund assets in private equities, as suggested in Clinton's proposal. This approach would fail because it is not aggressive enough. As mentioned previously, congressional scuffles would begin over how much and what types of investment instruments should be allowed. The level of United States' pension funds would be only marginally affected and wind up with relatively few dollars being invested privately.

The second option is to privatize a significant portion of the current program by directing five percentage points of each worker's contributions (taken out of the present 12.4% contribution rate) to a "Personal Security Account."²²⁶ Transition costs would require additional funding equivalent to 1.52% of taxable

²²³ See H.R. DOC. NO. 105-72, *supra* note 11.

²²⁴ See Hugo K. Mena, *Reforma Provisional y Ahorro Interno: La Experiencia Chilena*, ESTE PAIS (Mexico), Nov. 1, 1997.

²²⁵ See *id.*

²²⁶ H.R. DOC. NO. 105-72, *supra* note 11.

earnings over the first seventy-two years.²²⁷ This approach raises concerns as to where the United States would obtain this funding. Certain of the aforementioned “tweaks” that Congress is considering implementing may create necessary funds. The solution of adjusting the consumer price index 1.1% to match inflation “could save \$1 trillion in 12 years [and] [b]enefits checks would still rise with the true cost of living”²²⁸ Additionally, the age of entitlements could be raised to sixty-seven or sixty-eight. When the age of sixty-five was chosen in 1935, the average life span was sixty-two; it is now seventy-six.²²⁹ These changes, combined with a true effort to balance the budget, could fund the transition.

Partial privatization has been suggested to the Senate Budget Committee Task Force on Social Security by Sylvester Schieber, Ph.D., director of research at Watson Wyatt Worldwide.²³⁰ Dr. Schieber reported that the Social Security rate of return is “less than the intermediate government bond rate of return, essentially the most conservative alternative investment vehicle available to workers.”²³¹ Thus, United States workers are being forced to invest their employment earnings into a fund with lower returns than those received from investments in private insurance companies. The Watson Wyatt analysis concludes that the “current system can be restructured to give workers a mix of individual accounts and a reduced level of Social Security benefits. This would ameliorate the down-side risks of a fully privatized system for low-wage laborers, while continuing to provide potentially increased rates of return for many workers.”²³² This approach combines the best of both worlds without the prohibitively high transition costs.

The third approach recommended by the Advisory Committee is to scale back benefits so that they may be financed by the

²²⁷ See *id.*

²²⁸ Thomas & Thomas, *supra* note 183.

²²⁹ See *id.*

²³⁰ See *Social Security Rates of Return Shortchange Workers: Watson Wyatt Expert Testifies Before Senate on Social Security Reform* (last visited Apr. 1, 1999) <<http://www.prnewswire.com>>. Watson Wyatt Worldwide is a leading global management consulting firm with more than 5,000 associates in thirty-six countries.

²³¹ *Id.*

²³² *Id.*

current 12.4% contribution, followed by the establishment of a defined contribution benefit plan (an individual account) for each worker.²³³ The account would be created through an additional 1.6% mandatory contribution to an investment account managed by the federal government. Unfortunately, scaling back benefits to accommodate the 12.4% rate while demanding an additional 1.6% contribution is potentially problematic. Moreover, the 1.6% increase appears too modest to truly change a worker's retirement fund, especially if it is to be managed by the federal government. The fund probably would parallel the present system because the OASDI trust fund invests in the most conservative of all investments: domestic bonds.

The public is unlikely to support a program that requires larger individual contributions for the government to invest as it deems fit. The Chilean system is successful, in large part, because people exercise control over their own investments.²³⁴ Allowing U.S. workers to direct their money into a personal security account could promote savings and create further incentives to work. Such individual involvement would eliminate feelings of helplessness that arise from the lack of control over the individual 12.4% contribution.

The United States should look to the example of the United Kingdom, where in 1986²³⁵ over 80%²³⁶ of the population chose to privatize their pensions. The U.K.'s Social Security Act reduced the required worker contributions, allowing them, instead, to participate in the approved Personal Pension Scheme (PPS) of the worker's own choosing.²³⁷ While the United Kingdom's system is new and the economic stature of the country is quite distinct from the United States', the U.K. example does provide evidence

²³³ See H.R. DOC. NO. 105-72, *supra* note 11.

²³⁴ See *20/20: Retired and Rich*, *supra* note 19, at 12-13. Fred Salloway, a writer for union publications, asserted that the Chilean system was a failure for the average Chilean. John Stossel interviewed a number of Chilean citizens and one stated, "Today's system is better because they explain where the money is. You can see what's happening with your money." The feeling of control over a worker's money and his/her investments is extremely important in evaluating a Social Security System. See generally Symposium, *Private Pensions and the Public Interest: A Symposium Sponsored by the American Enterprise Institute for Public Policy Research, Washington D.C. (1970)*.

²³⁵ See Paskin, *supra* note 21, at 2220.

²³⁶ See *20/20: Retired and Rich*, *supra* note 19.

²³⁷ See Social Security Act, 1986, ch. 50 (Eng.).

that privatization may work in an industrialized, mature economy.

7. CONCLUSION

Reports by the Advisory Council, Watson Wyatt, and the Kerry-Danforth Commission lead to the conclusion that partial privatization would best serve American workers.²³⁸ The transition to partial privatization, while neither simple nor quick, is necessary. Hopefully, when implementing the system, the members of Congress can avoid partisan divisions, looking instead to the needs of their constituents. While some argue that the transition could not be a sweeping one,²³⁹ the OASDI Reports indicate that the United States has very little time left.²⁴⁰ The U.S. must use the balanced budget, tax cuts and additional fiscal tightening measures to provide for its citizens' futures. Privatization of the system could help by creating incentives to save and lowering the overall burden on the federal government, thereby reducing deficit spending and possibly even eliminating the welfare state as it exists today.

While Clinton's plan is a positive step, the United Savings Accounts must require a mandatory contribution which varies in an amount depending on income and allows the investor to control the proceeds. Because most wealthier workers have already invested in the market and obtained 401k and other IRA plans, education must be an integral part of this reform, as those who most need to invest are often those unfamiliar with investment strategies. Strict guidelines and limitations on government borrowing from the Social Security Trust Funds must be imposed. If a surplus materializes, it must stay in the funds to allow the 6.75% return to grow and to protect the fund in case of a market crash. The government must also be committed to insulating the fund from investments motivated by favoritism or cronyism. A large investment interest in one financially weak company could destroy the fund entirely.

Privatization would open the financial capital markets to more people, minimizing the capitalist image of the wealthy getting wealthier. Replacing this tradition would be a better one

²³⁸ For a comprehensive analysis of the proffered plans, see *infra* Section 6.

²³⁹ See Paskin, *supra* note 21, at 2222.

²⁴⁰ See *infra* graph at 115.

with workers taking responsibility for investing their money in their own futures, not someone else's.

* * * * *