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Is Social Security Reform Paternalistic?

by John Attarian

One great, and valid, complaint about Social Security is that it is paternalistic: it does things for the individual that he should do for himself. In so doing, it commits the twin transgressions of forcing some people to support others and making the beneficiaries the servile dependents of the state.

Accordingly, Social Security privatization has gained attention among critics. Supposedly, privatization will give young people more freedom to make their own decisions about what to do with their own money, instead of merely forcing them to support retired strangers, as they now do under Social Security.

Unfortunately, the devil, as always, is in the details. It turns out on close scrutiny that many reform proposals are in fact more paternalistic and smothering than Social Security itself.

Make no mistake, Social Security is paternalistic in the two senses noted above. First, in providing old-age, survivors, and disability benefits, it usurps the individual's responsibility to make prudent provision for his old age or disability and for the well-being of dependent family members who would suffer financially if he died. In so doing, it encourages individuals to take less thought for the future and to make less provision for it. In short, Social Security encourages them to behave less like prudent, future-conscious, responsible adults and more like feckless, irresponsible, improvident children.

Second, and perhaps more important, its taxes have become so high that they frequently make it difficult or impossible for working Americans of modest incomes to save and invest for their old age. Both Social Security's tax rate and the maximum labor income subject to tax have risen steadily and enormously since Social Security's tax went into effect in 1937. From 1937 to 1949 an employee's Social Security tax rate was 1 percent, and the maximum taxable income was $3,000, making an employee's maximum tax $30. Today, Social Security's Federal Insurance Contribution Act (FICA) tax rate is 6.2 percent each for an employee and his employer, and the self-employed face a tax rate of 12.4 percent. An employee making $20,000 in 1970 paid $327.60 in FICA taxes; a self-employed worker making that amount paid $491.40. Today, an employee earning that amount pays $1,240; his self-employed counterpart pays about $2,480.[1] Obviously, it is becoming increasingly difficult for workers carrying such tax burdens to save for their old age. This means that Social Security's tax is forcing taxpayers into dependence on Social Security for their retirement income.

However, Social Security leaves the taxpayer free to do as he likes with any money

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he has left after he has paid his Social Security tax. He can spend it on current consumption, save it for old age, or save for it some other purpose—and how he saves for old age is up to him. Once he's coughed up his tax, he's out from under Social Security's control.

This is not true, alas, of many reform plans. On the contrary, under these plans the payment of the tax is only the beginning, not the end, of paternalistic control over the individual. Let us examine the relevant features of a few representative proposals.

Some plans would add a small individual retirement account to the existing program. For example, two members of the 1994–1996 Social Security Advisory Council proposed raising the Social Security tax by 1.6 percentage points and investing this money in publicly held individual accounts (IAs). When the worker retires, but no earlier than age 62 (the earliest age at which one can collect Social Security retirement benefits), the account's accumulated funds would be converted into an annuity, which would have a guarantee that some share of the purchase price would be paid.[2]

Two-Tier Systems

Many privatization plans propose dividing the existing Social Security tax into two "tiers." One tier would pay benefits for current retirees; the other would be diverted into mandatory individual retirement accounts, which would be invested in stocks and other financial instruments.

A subgroup of the 1994–1996 Social Security Advisory Council advanced one such plan. Workers over 55 in 1998 would stay in the current Social Security program, which the two-tier system would gradually replace. All workers under 55 in 1998 would have their tax split into Tier I (7.4 percent of taxable payroll) to pay a flat Social Security benefit and Tier II (5 percent of taxable payroll) to be deposited into privately held Personal Security Accounts (PSAs).[3]

Stanford University economist John Shoven propounded a similar plan, which would entail putting 5 percent of taxable payroll into individual accounts, through mandatory individual contributions of 2.5 percent of payroll, matched dollar for dollar with Social Security taxes. When the worker retired, half the money in the account would be converted to an annuity.[4]

Chile introduced a more radical reform in 1981 to replace its social security system. A worker could choose to participate in a new program in which the employer deposits 10 percent of the worker's wages each month into an individually owned Pension Savings Account, to which the worker may contribute an additional 10 percent of his wages. He can choose from among a dozen government-approved investment companies to manage the account. On retirement the worker can use the money in his account to buy an annuity, or leave it in the account and make regular withdrawals.[5]

Social Security analysts Peter Ferrara and Michael Tanner of the Cato Institute have expounded a similar plan. Workers could choose to leave Social Security and enter a new system under which the worker and employer would each put 5 percentage points of the Social Security tax into an individual investment account. The worker "would be required to choose from among approved private investment companies" to manage his account. On retirement the worker, as in Chile, could make regular withdrawals, buy an annuity, or both.[6]

Far from being advances, these reform plans are replete with paternalism. One cannot help but think of a mother fussing over a little boy.

To begin with, every one of them entails forced saving through taxes—either a portion of the existing Social Security tax or some new additional tax. Mommy forces you to put money into a piggy bank, presumably on the assumption that you're too stupid or irresponsible to decide to do it on your own, that left to yourself you'd buy candy bars and comic books. What if you don't want to be forced to save? Shut up and drop your nickel in the slot, Billy. Mommy knows best.

Next, some plans restrict how the money in the accounts can be invested. Under the IA

plan, "Individuals would have constrained investment choices" for the money, ranging from a portfolio of bond-indexed funds to equity-indexed funds.[7] (Want to buy numismatic coins instead? Too bad. One can almost hear Mommy now: "No, no, Billy, you don't want those silly old coins; you want some nice, sensible stocks and bonds.") The Ferrara-Tanner plan requires that some of the money in the account "would have to be used" to buy private insurance paying survivors and disability benefits at least as generous as Social Security's.[8] So once your nickel is in your piggy bank, Mommy makes rules on how it's spent—for your own good, of course.

Finally, many plans constrain the disposition of the money on retirement. Under all the IA plans, individuals can start collecting their money only at retirement, not before. To its credit, the PSA plan does not require annuitization, thus giving the individual somewhat more freedom of choice than the IA proposal does. The IA plan mandates annuitizing the account money at retirement because "It will be very hard for these workers, upon retirement, to determine how much money they will need to provide for their very old age, in the face of inflation and many other uncertainties. . . . Some restrictions on the potential overspending of the newly-retired seem to us sensible; some annuitization important." This "protects people against the financial risk of living a very long life."[9] Similarly, Shoven's plan mandates annuitizing half the money in the account, in case "some people would blow all of their tier-two accumulations" and end up "below the poverty line."[10] Mommy knows best.

Restricted Withdrawal

The Ferrara-Tanner plan restricts withdrawals from accounts during employment and allows only annuitization or periodic withdrawals from the account at retirement, or both. If periodic withdrawals are chosen, they are limited "so the retiree could not use up all the funds early and then be left without retirement support."[11]

The state, then, would force you to save your own money, tell you how you could save it, and decide when you could get it back, how much, how often, and in what form. This is clearly a far messier, more meddlesome paternalism than Social Security's straightforward redistribution. The more statist plans, such as the IA plan, tack this new paternalism onto the existing paternalism of Social Security, making the total paternalism greater. The more libertarian reforms, such as the PSA, Shoven, and Ferrara-Tanner plans, merely replace one species of paternalism with another.

Have we forgotten Alexis de Tocqueville's prescient warning about "democratic despotism" and smothering paternalism? The government, Tocqueville wrote, becomes "an immense and tutelary power," taking it upon itself to watch over its people's fate, thus keeping them in "perpetual childhood." □

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1. *2000 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds*, pp. 34–35.
2. *Report of the 1994–1996 Advisory Council on Social Security*, 2 vols., 1997, vol. I: *Findings and Recommendations*, pp. 28–29.
3. Ibid., pp. 30–35.
4 John B. Shoven, "Two Tiers are Better than One," in Henry J. Aaron and John B. Shoven, *Should the United States Privatize Social Security?* ed. Benjamin M. Friedman (Cambridge, Mass., and London: MIT Press, 1999), pp. 30–47.
5. Peter J. Ferrara and Michael Tanner, *A New Deal for Social Security* (Washington, D.C.: Cato Institute, 1998), pp. 133–34.
6. Ibid., pp. 168–71.
7. Report of the 1994–1996 Advisory Council on Social Security, vol. I, p. 28.
8. Ferrara and Tanner, p. 169.
9. *Report of the 1994–1996 Advisory Council on Social Security*, vol. I, pp. 28, 30, 157.
10. Shoven, p. 47.
11. Ferrara and Tanner, pp. 169–71.