

Privatization of Social Security

Introduction

Privatization of Social Security is an increasingly prominent debate in the American political realm as well as amongst its citizens. The merits of the program have been debated since inception, with critics such as Republican Alf Landon in his 1936 presidential campaign calling the program "a cruel hoax". The program purports to be the largest annual transfer of wealth, and in 2008 total benefits of \$625 billion were paid out versus income (taxes and interest) of \$805 billion. 162 million American and employers paid into the program and 51 million received benefits¹. Different estimates have been put forward as to when the program will actually begin running deficits and how serious the problem is, but the general consensus² is given the aging population demographics, the increase in life expectancy, and current / expected low birth rates the program will begin to face into trouble around 2018.³ One suggested solution to the potential "crises" has been the idea of full or partial privatization. The ramifications of privatization are far reaching, and given the importance the repercussions the decision to privatize must be carefully studied and the benefits versus costs efficiently weighted.

General Argument for/Against

The conservative position is often pro-privatization. The primary argument revolves around the right of an employee to control the fruits of their labor and that the current scheme forgoes potential higher returns that could translate into greater benefits. The liberal position is typically anti-privatization, and is generally prompted by the idea that first and foremost privatization is not an answer to the funding shortfalls. Privatization opponents believe that as a social program it must provide a minimum level of income to retirees, which privatization may actually hamper⁴.

Our Proposal

We do not take the view that privatization is either good or bad, rather we plan to attempt to analyze some of the externalities that may have not been brought into the debate that have important repercussions. In particular, using Micro-simulation, this study will explore not only the effects of privatization on the overall value of retirement accounts, a study possibly better achieved via trading general equilibrium and/or forecasting models, but rather the externalities of privatization and how consumer, savings, and supplemental retirement planning decisions may be affected. Using micro-simulation with the rich cross sectional data regular collected by the Census Bureau and the Social Security Administration we plan to highlight the choices that various types of households (i.e. income class, family demographic, and other household survey data) may ultimately make if Social Security is ultimately privatized. Micro-simulation allows us to avoid the necessity of making general assumptions of decisions of a "typical" individual. Secondly, once the simulation model is calibrated we can test the effects of various types of privatization proposals on choices. I.E. is there an optimal mix between privatization and government sponsored, how many privatization choices should be offered, how does a guaranteed level of payment affect choices, will consumers consider themselves wealthier if they have more control and transparency and thus increase spending, should the funds be available for borrowing against if the geared investments are also retirement focused. Lastly, micro simulations allows

¹ 2008 Social Security - Trustees Report Summary Press Release available at: <http://www.ssa.gov/pressoffice/pr/trustee09-pr.htm>

² Some argue that indeed there are no expected problems and the issue has been blown out of proportion and the debate surrounding privatization is really founding on the idea of the expected windfall that investment firms stand to make if Social Security is privatized. See for example The False Promise of Social Security Privatization Miron and Murphy (2001) for more details or Krugman, Paul (December 7, 2004). "Inventing a Crisis". The New York Times. <http://www.nytimes.com/2004/12/07/opinion/07krugman.html?scp=539&sq=&st=nyt>.

³ 2009 Social Security OASDI Trustees Report - Overview available at: <http://www.ssa.gov/pressoffice>

⁴ Twelve Reasons Privatizing Social Security is a Bad Idea, available on <http://www.socsec.org/publications.asp?pubid=503>

for a structure that better represent the heterogeneity in the cross sectional data and the evolution of effects over time. The ultimate aim is to build a model in which both pro/anti privatization researches can input their assumptions and quickly see what the ramifications are for a variety of consumers choices as well as the ultimate positions of retirees.

General Proposal Outline:

Problem Statement

Previous Research in the area

The pros of micro-simulation as well as the shortcomings, and how they relate to the problem

How / what data would be sourced

What are the expected outcomes and capabilities of the proposed model?