erally "went to sleep" during the decade of the 1980s, and kept sleeping after the death of socialism. The result is that public attitudes today are more shaped by the nanny state, or by paternalist, rent-seeking, mercantilist regimes than they are by liberal ideals.

Creating a new vision, a new soul for liberalism, is our most important task now. I am not here suggesting that attention should be limited to the design of all-inclusive political packages. Politics, for the most part, proceeds in piecemeal fashion, one step at a time. What I am suggesting is that we, those who teach liberalism, focus on the vision, the constitution of liberty, rather merely on pragmatic utilitarian calculus that shows liberalism to yield quantifiably better results than politicized economies.

In other words, liberals should not lean back and say, "our work is done." The organization and the intellectual bankruptcy of socialism in our time has not removed the relevance of a renewed and continuing discourse in political philosophy. We need discourse to preserve, save, and recreate that which we may, properly, call the soul of classical liberalism. Without public understanding of its organizing principles, the extended market order will not survive.

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# SPEAKING THE TRUTH ABOUT SOCIAL SECURITY REFORM

BY MILTON FRIEDMAN

The journalist Michael Barone summed up the conventional wisdom about reforming Social Security. "The content of the reform is fairly clear—individual investment accounts to replace *part* of the government benefits financed by the payroll tax, later retirement ages, adjusted cost of living increases," he wrote in the *American Enterprise*. And, he added, "suddenly the money to pay for the *costs of transition* is at hand, in the form of a budget surplus."

I have italicized "part" and "costs of transition" because they epitomize key defects in conventional wisdom.

Social Security has become less and less attractive as the number of current recipients has grown relative to the number of workers paying taxes, an imbalance that will only get bigger. That explains the widespread support for individual investment accounts. Younger workers, in particular, are skeptical that they will get anything like their money's worth for the Social Security taxes that they and their employers pay. They believe they would do much better if they could invest the money in their own 401(k)s or the equivalent.

But if that is so, why replace only part and not all of government benefits? The standard explanation is that this is not feasible because payroll taxes—or part of them—are needed to pay benefits already committed to present and future retirees. That is how they are now being used, but there is nothing in the nature of things that requires a particular tax to be linked to a particular expenditure.

**The Myth of Transition Cost**

The link between the payroll tax and benefit payments is part of a confidence game to convince the public that what the Social Security Administration calls a social insurance program is equivalent to private insurance; that, in the administration's words, "the workers themselves contribute to their own future retirement benefit by making regular payments into a joint fund."

Balderdash. Taxes paid by today's workers are used to pay today's retirees. If money is left over, it finances other government spending—though, to maintain the insurance fiction, paper entries are created in a "trust fund" that is simultaneously an asset and a liability of the government. When the benefits that are due exceed the proceeds from payroll taxes, as they will in the not very distant future, the difference will have to be financed by raising taxes, borrowing, creating money, or reducing other government spending. And that is true no matter how large the "trust fund."

The assurance that workers will receive benefits when they retire does not depend on the particular tax used to finance the benefits or on any "trust fund." It depends solely on the expectation that future Congresses will honor promise made by earlier Congresses—what supporters call "a compact between the generations" and opponents call a Ponzi scheme.

The present discounted value of the promises embedded in the Social Security law greatly exceeds the present discounted value of the expected proceeds from the payroll tax. The difference is an unfunded liability variously estimated at from $4 trillion to $11 trillion—or from slightly larger than the funded federal debt that is in the hands of the public to three times as large. For perspective, the market value of all domestic corporations in the United States at the end of 1997 was roughly $13 trillion.

To see the phoniness of "transition costs" (the supposed net cost of privatizing the current Social Security system), consider the following thought experiment: As of January 1, 2005, the current Social Security system is repealed. To meet current commitments, every participant in the system will receive a governmental obligation equal to his or her actuarial share of the unfunded liability.

For those already retired, that would be an obligation—a treasury bill or bond—with a market value equal to the present actuarial value of expected future benefits minus expected future payroll taxes, if any. For everyone else, it would be an obligation due when the individual would have been eligible to receive benefits under the current system. The maturity value would equal the present value of benefits the person would have been entitled to, less the present value of the person's future tax liability, both adjusted for mortality.

The result would be a complete transition to a strictly private system, with every participant receiving what current law promises. Yet, aside from the cost of distributing the new obligations, the total funded and unfunded debt of the United States would not change by a dollar. There are no "costs of transition." The unfunded liability would simply have become funded. The compact between the generations would have left as a legacy the newly funded debt.

How would that funded debt be paid when it came due? By taxing, borrowing, creating money, or reducing other government spending. There are no other ways. There is no more reason to finance the repayment of this part of the funded debt by a payroll tax than any other part. Yet that is the implicit assumption of those who argue that the "costs of transition" mean there can be only partial privatization.

The payroll tax is a bad tax: a regressive tax on productive activity. It should long since have been repealed. Privatizing Social Security would be a good occasion to do so.

**Should Social Security Be Mandatory?**

Should a privatized system be mandatory? The present system is; it is therefore generally taken for granted that a privatized system must or should be as well.

The economist Martin Feldstein, in a 1995 article in the *Public Interest*, argued that contributions must be mandatory for two reasons. "First, some individuals are too shortsighted to provide for their own retirement," he wrote. "Second, the alternative of a means-tested program for the aged might encourage some lower-income individuals to make no provision for their old age deliberately, knowing that they would receive the means-tested amount."

The paternalism of the first reason and the reliance on the extreme cases of the second are equally unattractive. More important, Professor Feldstein does not even refer to the clear injustice of a mandatory plan.

The most obvious example is a person with a terminal disease who has a short life expectancy and limited financial means, yet would be required to use a significant fraction of his or her earnings to accumulate what is almost certain to prove a worthless asset.

More generally, the fraction of a person's income that it is reasonable for him or her to set aside for retirement depends on that person's circumstances and values. It makes no more sense to specify a minimum fraction for all people than to mandate a minimum fraction of income that must be spent on housing or transportation. Our general presumption is that individuals can best judge for themselves how to use their resources. Mr. Feldstein simply asserts that in this particular case the government knows better.

In 1964, Barry Goldwater was much reviled for suggesting that participation in Social Security be voluntary. I thought that was a good idea then; I still think it is.

I find it hard to justify requiring 100 percent of the people to adopt a government-prescribed straitjacket to avoid encouraging a few "lower-income individuals to make no provision for their old age deliberately, knowing that they would receive the means-tested amount." I suspect that, in a voluntary system, many fewer elderly people would qualify for the means-tested amount from imprudence or deliberation than from misfortune.

I have no illusions about the political feasibility of moving to a strictly voluntary system. The tyranny of the status quo, and the vested interests that have been created, are too strong. However, I believe that the ongoing discussion about privatizing Social Security would benefit from paying more attention to fundamentals, rather than dwelling simply on the nuts and bolts of privatization.

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# 10 MYTHS ABOUT SOCIAL SECURITY REFORM

BY DAVID C. JOHN

The arguments against Social Security reform have rested on a great deal of incorrect and misleading information. These myths make it hard for workers to make informed decisions on their retirement finances that will affect not only their own well-being, but also that of their children and grandchildren.

A review of the common misconceptions about Social Security reform and the personal retirement accounts that have been included in proposals for reform will go far to promote a meaningful and productive debate.

**Myth 1**: Introducing Social Security personal retirement accounts reduce benefits for existing retirees and those close to retirement.

**Fact**: For now, Social Security is collecting more than enough money to pay both full benefits to those who have retired or are about to retire and to establish personal retirement accounts. As time goes on, the extra money needed for these accounts can easily be found using today's method of financing Social Security. Under all circumstances, benefits to retirees and to those close to retirement will be paid in full.

**Myth 2**: Unlike investment in the stock market, today's Social Security is risk free.

**Fact**: Social Security is subject to the risk that future generations may not be willing to pay the ever-higher costs of the promised benefits. If nothing is done, either taxes must climb by about 50 percent or Social Security benefits must be cut by about 35 percent.

**Myth 3**: The Social Security trust fund contains assets that make Social Security secure for the next forty years.

**Fact**: The Social Security trust fund is essentially the government lending money to itself, and then spending it. There is no pool of actual assets for paying future benefits. According to the Social Security Administration, starting in 2017, the government is going to have to come up with a total of about $6 trillion in new money just to repay the bonds in the trust fund.

**Myth 4**: If Congress would stop spending the Social Security surplus and repay that money, there would be no need to fix Social Security.

**Fact**: Even if there were a way for the federal government to invest the Social Security trust funds, repaying the borrowed money would only delay Social Security's financial problems. It would not solve them.

**Myth 5**: We can't afford to establish personal retirement accounts, because starting such a system would suck between $1.0 trillion and $1.3 trillion out of the trust fund in the first 10 years alone. The Trust Fund would be exhausted 14 years sooner.

**Fact**: It is actually cheaper to establish personal retirement accounts than it is to do nothing. The exact amount needed in the first ten years will depend on the plan adopted, but it will probably be much less than what opponents claim. While transition costs would begin sooner with personal retirement accounts than if we do noth-