From Thatcher (and Pinochet) to Clinton? Conservative Think Tanks, Foreign Models and US Pensions Reform

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THE ongoing debate among policy-makers in the Western welfare states about the structure of pension systems has been framed by a conventional wisdom depicting a developing demographic time-bomb, as the aged population grows in relation to the overall population. This scenario depicts the demands of the retired and their dependants overwhelming the capacity of the state as it becomes impossible to transfer enough income from the working-age population to maintain a decent standard of living for the elderly. Various proposed solutions to this perceived problem have been put forward, with conservative analysts in particular keen to take the opportunity to champion the virtue and flexibility of the private sector as an alternative to what they portray as the bankruptcy of the state in both policy and fiscal terms. The centre-left's response has been to defend the integrity of state income guarantees to the elderly, yet at the same time to accept that government's role as a direct provider might need to be reduced, with a greater emphasis on the state acting as a regulator of private pension provision. Conservatives may respond that this is an inadequate response and that a commitment to a more fully-fledged privatisation is required; but in the long term they may come to see any move away from straightforward tax-funded pension schemes as a Trojan horse from which they can emerge to launch further attacks on the credibility of government-run programmes.

One country where the debate about the continuing viability of the existing government-run pension system has recently intensified is the United States. Given America's reputation for scepticism towards the value of state welfare programmes, this might not appear to be an unexpected development to a European audience. In some respects, however, the readiness of the US political class to take on the question of pension system reform is surprising. Social Security, as the pension system is known in the US, is commonly referred to as the 'third rail' in American politics—'touch it and die'—due to the strong public support for the programme. Social Security is popularly understood as conforming to the social insurance model of welfarism: that is, people pay into the scheme in the expectation of being reimbursed when they retire, and the fact that the programme contains an element of income redistribution receives relatively little attention. Thus, although the issue remains extremely politically sensitive, the willingness of the major players from across the political spectrum to talk about restructuring the system suggests that they see the problem as a genuine one.

An interesting feature of the debate has been the manner in which elements of the influential conservative think-tank community have pointed to developments outside the US as suggesting a way ahead. Given that the pension problem is deemed to be one universal to Western

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welfare states, it would be surprising if there were not some cross-fertilisation of ideas; but American conservatives have traditionally pointed to the dangers of what happens abroad rather than looking to borrow social policy solutions from overseas. In this instance, however, they have been happy to point to foreign models in an effort both to reinforce the general idea that something must be done and to press the case that this something should be a move away from government-run programmes towards increased involvement of the private sector. This, conservatives insist, would simultaneously help solve the looming fiscal crisis and also introduce new elements of individual choice into the American pension system.

Two of the countries on which American conservatives have focused attention are Chile and the United Kingdom. The former represents an ideological conservative's fantasy island, but the latter provides perhaps a more practical guide to changes that might successfully be adopted in the US. The use of the UK as a model is particularly interesting as it reverses the direction of the recent flow of ideas between the two countries on social policy issues.[1] It is important in this context, however, to understand that American conservatives are not proposing to imitate directly reforms and proposals from abroad, but to use foreign examples to justify their attack on what is by far the largest welfare state programme in the US.

This article will examine the development of the theme of pension privatisation in the US, concentrating on the role of conservative think tanks and the manner in which foreign models have been used to augment the case that reform is necessary and inevitable. We will contest this perspective and argue that, although framed as an objective response to demographic and consequent fiscal pressures, the demand for pension privatisation is in fact more an ideological construction. Furthermore, the foreign examples are used in a selective manner, with scant regard paid to the significant differences in welfare state structures and minimal examination of the problems which have emerged where the state's role in pension provision has been diminished.

The making of a crisis

The old age insurance programme, created in 1935 as part of the Social Security Act, is the core of the American welfare state. Today, as the Old Age Survivors and Disability Insurance programme (OASDI), it covers 44 million beneficiaries. The system is financed by contributions from employees and employers and covers about 95 per cent of the workforce. The idea that the scheme is a form of insurance is encouraged by the manner in which employees pay a specific Social Security payroll tax, the proceeds from which are ostensibly allocated to a Social Security trust fund. In reality the federal government has been 'borrowing' money from this account in order to finance other spending, but the apparent relationship between the payroll tax and the trust fund at least creates the appearance that the money is being collected and set aside for a particular purpose in a fashion which is absent, for example, in the UK, where national insurance contributions are mixed with general tax revenues.

The political success of the programme owes much to the manner in which it has integrated the middle class while simultaneously acting as a redistributive device reducing poverty among the elderly. Its effectiveness as an anti-poverty programme for the aged increased dramatically during the Nixon years, when benefits were index-linked to inflation following a series of increases in payment levels. This helped reduce the poverty rate among elderly Americans from more than 35 per cent in 1959 to 11 per cent today, a rate which is lower than that for the general population.

The political strength of the programme was demonstrated in the early 1980s when President Reagan began to explore the possibility of reform but soon backed down from any fundamental change as polls showed strong opposition to this idea. An independent commission—chaired by Alan Greenspan—was established to look at the fiscal integrity of the system and in 1983 some changes were enacted, notably an increase in the rate of the payroll tax and a gradual increase in the retirement age from 65 to 67 over the period from 2000 to 2022. The significance of these changes should not be underestimated,[2] but the main characteristics of the system were preserved.

Partially as a result of these reforms, and also because of unexpectedly strong economic growth, the Social Security trust fund has since been raking in significantly more money than it has been paying out to current retirees. In theory, then, major surpluses should have been accumulated which would guarantee the medium-term fiscal soundness of the Social Security programme. In 1998 alone trust fund income exceeded payments by over $92 billion, leaving total reserves at the end of the year close to $682 billion. According to a recent official projection by the fund's Board of Trustees, total reserves are projected to reach a maximum of about $4.4 trillion in 2020. After this expenditures will overtake revenues and the reserves will fade progressively. It is calculated (or guessed) that by 2034 the system will face a solvency crisis.

Some commentators, moreover, have maintained that the solvency problem will come earlier, saying that it is unlikely that the federal government will pay back into the trust fund the money that it has taken for other spending; but not somehow to find a way of reimbursing the fund, if necessary through some creative accounting, would involve major political risk. On the other hand, these thirty-year projections are calculated assuming an annual rate of economic growth of less than 1.7 per cent—only about half the growth rate of the previous thirty years. It may well be, of course, that these projections are too optimistic should the US run into a severe and prolonged recession; the key point is, however, that calling for a major overhaul of the programme now on the basis of budgetary projections which need to be off-target by only a small fraction to have a considerable long-term impact is a dubious exercise.[3]

Despite the fact that a serious shortfall in the trust fund may be a long time off, the idea of reforming or even 'privatising' the pension system, that is, replacing government payments either partially or completely with compulsory individual investment accounts, is now at the centre of the American political debate, with demographic statistics being used to justify radical proposals. However, even though the baby-boomers will begin to retire in 2010 and the ratio of workers to retirees will change from 3 to 1 to about 2 to 1 in 2030, the American situation still compares quite favourably to that in many European countries, notably Sweden and France.[4]

Overall, then, it appears that there may be more to the push for reform than an objective analysis of the demographic and economic trends; and it is important to look at the ideological and political motives of those pushing most enthusiastically for change.

The role of think tanks

Among those calling most vociferously for reform have been conservative think tanks, notably the Heritage Foundation, the Cato Institute and the American Enterprise Institute. (It should be said that the third of these is sometimes more moderate than the other two.) In order properly to understand the contemporary political role of think tanks it is important to recognise how both their methods and their self-perception have changed over the last quarter-century. From the Progressive era through to the end of the 1960s these organisations acted mainly as research centres; since the 1970s, however, they have grown dramatically in number and, at the same time, have increasingly come to view themselves as advocacy tanks, campaigning through the media for distinctive ideological projects which their research findings conveniently support. There are, of course, groups from across the political spectrum; but on social policy issues conservative groups generated an ideological intensity and momentum in the 1980s which has since kept the liberal community on the defensive.

This think-tank activity on Social Security has led to an impressive array of research papers and policy briefs that are sent to journalists, members of Congress and government officials. Thus, even though it is difficult to evaluate their direct influence on policy-making, it seems clear that think tanks, particularly the conservative ones, have helped provide the framework for the contemporary debate on pension privatisation. Furthermore, it is important not to analyse the influence of these groups only in immediate legislative terms. Whether consciously pursued or not, an effective long-term strategy is to push proposals that are *now* considered too radical by most Americans, but which may begin to undermine confidence in Social Security and create a *future environment* for the passage of more conservative legislation. It is certainly possible to trace a similar pattern to this in the evolution of policy towards means-tested welfare benefits for single-parent families. The conservative proposals of Charles Murray and Robert Rector were initially dismissed by liberals who later found themselves powerless as many elements of these writers' platforms become law in 1996.

Since the mid-1990s a number of proposals for the reform of Social Security have been advanced, ranging from its partial to complete replacement by individual savings accounts. Advocates of change recognise that, in reality, only the idea of partial privatisation is currently on the political agenda and they have geared their efforts to persuading moderate members of Congress from both parties of the benefits of this approach. Although the detailed arrangements vary among the various different proposals, the essence of partial privatisation is that some of the current dedicated payroll tax would be transferred to a personal account which would be invested in the stock market, with the state continuing to assume the rest of the burden.[5]

Central to the privatisers' argument is the promotion of *individual choice*: they maintain that government-run social insurance is a form of state neo-despotism, preventing individuals from doing what they want with their own money. Paradoxically, however, most privatisers still favour the state imposition of a form of obligation, in the shape of compulsory individual savings accounts—meaning that individual choice would in reality be limited to investment choice.[6] Nevertheless, the ideology of individual freedom and the critique of Big Government are central to the campaign for privatisation, even if the government would be likely to play a big role in regulating stock markets and imposing the obligation to save. Conservatives also argue, although with little solid evidence, that the US's comparatively low savings rate would be improved by a switch from government-run to personal savings accounts.

This general championing of the virtues of freedom, however, is too abstract to convince most citizens that the shift from government-run social insurance to personal pension investment is the right way to go. A far more concrete argument and useful ideological weapon for privatisers comes from the bullish stock market performance of the 1990s, which provides some evidence for an assertion that the 'return rate' offered by private investments would be much higher than that currently on offer from Social Security. One particularly optimistic analysis by the Cato Institute maintained that there would be a whole new glut of millionaires if people were allowed to invest their Social Security contributions in the stock market.[7] Of perhaps more immediate relevance, the increasing participation in mutual and personal funds like the Individual Retirement Accounts and so-called 401(k) have already familiarised some of the public with stock investment.[8] This may lend greater credibility to those who champion the merits of allowing people to divert some of their payroll contributions away from the existing trust fund and into a personal investment portfolio.

Defenders of the current system, such as Robert Ball or Henry Aaron, fear that any shift to individual accounts would both create risks for individuals associated with stock market cycles and exacerbate social inequalities by reducing the redistributive element of the way in which benefits are now calculated. A critical issue here is the relationship between defined contributions and defined benefits.[9] In the government-run format both Social Security contributions and benefits are determined in advance by government, which collects the former and has an obligation to guarantee the latter. A personalised pension scheme might still place a levy on a fixed proportion of wages, but benefits would not be fixed in advance as returns would depend on investment choices made by individuals and the overall stock market performance. Put differently, even partial privatisation shifts some risk away from government and on to the individual, and also creates the possibility of the actual level of pension varying according to ability to 'play' the stock market. Anti-privatisation writers also argue that the transition and administrative costs of change would be much higher than the privatisers claim, thus eating into the supposed higher rates of return promised.

These writers, in fact, maintain that the anticipated long-term deficit of the Social Security trust fund can be contained by making some less dramatic changes within the current framework which would also avoid any direct increases in the rate of payroll tax or cuts in benefit levels. Indeed, some measures which would mildly increase the redistributive effect of the system, such as subjecting more of the benefits of wealthier retirees to taxation and/or raising the level at which the Social Security payroll tax is capped, could be used. Conservatives respond that such suggestions simply do not get to grips with the fundamental flaws in the existing system; and to reinforce their argument they point to developments outside the US as illustrative of the overall benefits that can come with more radical change.

Looking abroad

The US is often portrayed as the exception in the social welfare world, and in particular as trailing behind the advanced welfare systems of western Europe. There is, however, perhaps a greater tradition of US policy-makers studying social policy developments abroad than is commonly recognised. In particular, many Progressive and New Deal reformers looked to adapt European social programmes to the US context. During the Second World War, William Beveridge was invited to the US by the Social Security Board in order to explain the merits of an extended welfare state. At the end of the war, however, the US followed a different path from many European countries: as the US economy moved into overdrive and occupational benefits expanded, there was little pressure from the middle class to expand state welfare protections in the manner being implemented across western Europe.

During the 1950s and 1960s foreign models became even less relevant to American policy-makers. Welfare in America was provided through a mix of public programmes and private agencies, and was administered by a complex interaction between federal, state and local governments which seemed to distinguish the US from its European allies. With the advent of the Reagan administration it appeared that there was even less likelihood of the US looking to Europe for policy solutions. In American political discourse the countries of continental Europe and Scandinavia have been increasingly portrayed as the new 'laggards' in their failure to cut excessive social spending. Indeed, American conservatives feel that it is they who now have a product to export. In terms of pension reform, however, US conservatives have presented their own country as the laggard—in privatisation, failing to re-examine the foundations of Social Security in either the fundamentalist fashion of Chile or even the more limited manner of the UK.

From Thatcher (and Pinochet) to Clinton?

In 1981 Chile established its reputation as the pioneer of privatisation when the existing 'pay-as-you-go' social insurance programme, deemed to be in crisis as a result of ineffective management which had allowed massive evasion of payments by both employers and employees, was scrapped. In its place the Pinochet dictatorship introduced a system which required workers to contribute 10 per cent of their salaries to individual investment accounts. The architect of the new programme was the Minister of Labor and Social Security José Piñera, a Harvard-trained economist. Today this charismatic man lives in the United States and is a champion of Social Security privatisation in his adopted home. In his capacity as co-chairman of the Cato Institute Project on Social Security Privatisation and President of the International Center for Pension Reform, he has been invited to testify in front of US congressional committees on three occasions, and his views on Social Security reform are frequently aired in the media.

In his texts and testimonies Piñera insists that the Chilean experiment has been a success, with the retired having higher income levels than before. He has also reflected that the Chilean model fits well with the American credo about the primacy of the market over the state: 'I believe that the road is clear in the United States to replace a Bismarckian program with a system that is so inherently consistent with American values.'[10] Piñera's credibility in conservative circles, enhanced by his position at the influential and wealthy Cato Institute, is an important indication that foreign models are being exploited by conservatives to demonstrate that reform is not only possible but beneficial.

If Chile remains the favourite foreign reference for the privatisation lobby, the UK also receives significant attention. The Heritage Foundation recently published a set of papers on the 1986 British pension reform, and even the current Labour government's proposals on personal pensions published in December 1998 have been favourably mentioned in Heritage dispatches. Furthermore, in February 1999 Peter Lilley, former Secretary of State for Social Security, testified in front of the House's Ways and Means Committee to explain how the State Earnings Related Pension Scheme (SERPS), a supplement to the basic pension, had been downsized, with many people opting out of the scheme to start personal pension plans in the private sector.

It is perhaps not too surprising that American conservatives should look at the actions of the Thatcher/Major governments, but the fact that the Heritage Foundation has also applauded the pension initiative of the Blair regime is more interesting from both American and British perspectives. Although referring only to the general guidelines issued in December 1998 rather than to detailed legislative proposals, a Heritage document praised the principle of the 'stakeholder pension' for further undercutting SERPS and reducing the government's direct role in the collection of revenues and distribution of pension benefits. The implicit message to Bill Clinton and the New Democrats is clear enough: if Tony Blair can support more quasi-privatisation, why not follow his example?

Clinton's response

The Clinton administration has responded to the talk of crisis in pension provision by presenting its own plan. Announced in the January 1999 State of the Union address, the proposal is that 60 per cent of the overall anticipated forthcoming government surpluses be set aside for saving the Social Security system. Furthermore, part of this money would be invested in the stock market to get a better rate of return rate of return than from government bonds. To the administration this probably seems like an ingenious method of maintaining both the government's control over the system and also the fundamentals of a defined-contribution/defined-benefit structure. The fate of this proposal, however, is far from clear as its opponents, including the influential chair of the Federal Reserve Board, Alan Greenspan, fear that government involvement in the market could be disruptive to the natural value of stocks. For example, would government have to follow an 'ethical' investment policy and shy away from certain types of company stocks, even if these offered the best rate of return? Another feature of the administration's approach has been to suggest developing a voluntary, but federally subsidised, personal savings scheme, to be known as Universal Savings Accounts (USAs).

Clinton has championed his proposals in highly populist language, insisting both that any budget surplus be used to 'save Social Security first' and that the system be kept fully under government jurisdiction. Thus, in itself, this proposal is not enough to satisfy the wishes of the conservative privatisers; but in entering into the debate at all, and in then raising the possibility of investing a share of Social Security funds in the stock market and encouraging the greater use of personal pension plans, the administration may, inadvertently, have opened the gates for the privatisation Trojan horse.

Conclusion

At the time of writing the outcome of the debate on Social Security reform remains unclear. There is undoubtedly a prevailing sense that change is needed; but the necessary scope of this change remains in dispute. It does seem that the system could be preserved in its current government-run format, retaining its defined benefit and redistributive elements, with minor rather than major modifications. Nevertheless, those who would like to see a reduction in the government's role and the introduction of more individual choice have been laying the political groundwork for a sustained attack on the existing system, and a primary tool has been the use of examples from outside the United States.

This is not to say that conservatives maintain that American policy-makers should simply copy or import foreign schemes. The strategy is to refer to them to demonstrate that America is now not the 'welfare state laggard' but the 'privatisation laggard'; that is, the aim is to use the fact of reform abroad to demonstrate that reform is necessary, feasible and indeed desirable.

Furthermore, because they do not call for the systematic imitation of a particular foreign programme, and because they want to portray the road to privatisation as a relatively smooth one, conservatives maintain that the negative consequences of foreign reforms are not relevant to the US (without elaborating on why the positive aspects *are* relevant). However, while American conservatives may assume that they can avoid the particular pitfalls of others' experiences, such as the scandal of personal pension mis-selling in the UK, the assumption that mistakes on the road to reform can be avoided is too glib. The effects of dramatic changes in the financial sector can sometimes be hard to predict, as indeed the Savings and Loans disaster in the US revealed. In their ideological zeal privatisation advocates apply even less critical scrutiny to the Chilean experience—largely ignoring the enormous differences between the old Chilean pension system and the existing US Social Security system, overlooking continuing inefficiencies in the new Chilean system and showing indifference to the loss of a redistributive factor in pension provision.[11]

It is difficult as yet to judge whether the conservative strategy will pay off politically and help convince moderates from both parties to support a shift to private accounts and 'individual choice'. Whatever the outcome, however, the irony of the situation should not go unnoticed as American conservatives, who had come to see themselves as the pioneers of welfare state reform through the 1980s, are now recommending the ideas of a British Labour government in order to put pressure on Clinton and the New Democrats to implement some element of privatisation.

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Notes

1 See e.g. Desmond King and Mark Wickham-Jones, 'From Clinton to Blair: The Democratic (Party) Origins of Welfare to Work', *Political Quarterly*, 1999, pp. 62–74.
2 According to Henry Aaron and Robert Reischauer, this change to the retirement age in fact represents a 13 per cent benefit cut: see their *Countdown to Reform: The Great Social Security Debate*, New York, Century Foundation Press, 1998, p. 101. On the 1983 reform, see Paul Light, *Still Artful Work: The Continuing Politics of Social Security Reform*, New York, McGraw-Hill, 1995.
3 This is illustrated by the fact that the designation by the 1999 Trustees Report of 2034 as the year the fund would go bankrupt represented a two-year stay of execution from the 1998 Report: *1999 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Fund*, Washington, 30 March 1999.
4 In Sweden, 18.2 per cent of the Swedish population is currently 65 or over, and it is calculated that by 2025, 25.7 per cent of the French population will be so. In the US, even at the later date, it is estimated that the elderly will constitute only 19.2 per cent of the population: US Bureau of the Census, IPC/95-2, *Older Workers, Retirement, and Pensions: A Comparative International Chartbook*, Washington DC, US Government Printing Office, 1996.
5 For a presentation of all the different proposals, see Aaron and Reischauer, *Countdown for Reform*, pp.120–47.
6 Milton Friedman has proposed a purely voluntary saving scheme: see 'Social Security Chimeras', *New York Times*, 11 January 1999, p. A 21.
7 Peter Ferrara and Michael Tanner, *A New Deal for Social Security*, Washington DC, Cato Institute, 1998.
8 Steven Teles, 'Pensions, Social Citizenship and the Ubiquity of the State: The Relevance of the British Privatization Experience in the United States and Beyond',

workshop on Social Policy and Devolution, Brandeis University Center for German and European Studies, 12–13 March 1999.

9 See John Plender, 'Ownership and Pensions', *Political Quarterly*, 1998, pp. 395–403.

10 'A Real Solution to the Social Security Crisis', *Testimony of José Piñera before the US House Committee on Ways and Means*, 11 February 1999, p. 18. See also 'Empowering Workers: The Privatisation of Social Security in Chile', *Cato's Letter No. 10*, Cato Institute, 1996.

11 See Stephen Kay, 'The Chile Con: Privatising Social Security in South America', *The American Prospect*, July–August 1997, pp. 48–52.