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I wrote a book about Social Security reform. The work came out to be 125 pages divided among eight chapters. I will briefly go over what I describe in each.

But let us first quickly review the structure of Social Security. Social Security provides benefits to survivors, dependents, the old, and the disabled. The system is financed by a 12.4% marginal tax (15.3% including the FICA tax) on labor split between employees and employers. There is a cap on the amount of income subject to this payroll tax; currently, the first $90,000 of income is taxable. Social Security is a pay-as-you-go system, with tax receipts immediately becoming transfer payments. In other words, the checks employers send to the Treasury on behalf of their workers are more or less straightaway transferred to beneficiaries.

Now on to the first chapter and the big problem, which is basically that Social Security in its current form will run out of money. The primary reason for this is demography. A population chart that was once pyramidal is becoming boxy, with the number of oldsters rivaling the number of the young and middle-aged. Life expectancy has risen dramatically, with the 85-plus club growing fastest, meaning that Social Security disburses benefits to retirees for an increasingly greater number of years. Declining birthrates and a substantial increase in the number of retirees have resulted in a dramatic decline in workers per beneficiary. Workers are supporting more retirees with their taxes than they used to, and the benefits those retirees receive have also increased dramatically *on a real basis*—that is, adjusted for inflation. This increase has occurred because initial benefits are indexed to wages, which typically grow some 1% faster than prices, such that purchasing power increases for every succeeding generation of retirees, indeed, every year. The combination of adverse demographics and price indexing, among other things, will result in insolvency. And all the while, workers will require more and more years to recoup their payroll taxes as the system's already low yield declines more.

In this chapter I also outline the negative economic consequences of maintaining the present system, focusing especially on the labor supply, national saving, and the effect on investment and economic growth.

In the second chapter, I outline why other factors complicate these pensions difficulties. Consider two of these complicating factors. First, the rapid aging of Europe, Japan, and other Asian countries will put enormous strain on its generous transfer programs, further limiting the availability of capital to finance American indebtedness over the long term. Second, American military spending promises to increase at a steady clip, with weapons procurement costs probably larger on a real basis than even those of the Star Wars era. Cost overruns are typical, since many defense costs are legislated through emergency bills and therefore do not appear beforehand on standard fiscal projections. And there is just about no limit to the number of expensive domestic security measures Congress might deem it necessary to fund, including providing first responders with gear needed to combat biological attacks and checking all cargo containers at our nation's ports. The government ought to get a handle on what it can control; natural disasters and terrorists won't be so obliging.

The third chapter debunks some common myths. Consider one example: taxpaying citizens commonly suppose that they have a right to Social Security benefits. The Supreme Court disagrees. In two cases, *Helvering v. Davis* and *Flemming v. Nestor*, it made clear that no citizens have any legal claim on Social Security benefits. Indeed, Congress has the ability to reduce benefits any time it pleases; in fact, it already has by legislating a gradual rise in the retirement age and the taxation of Social Security benefits.

The fourth chapter is a tour of other countries' pension reforms, with a special focus on Chile and Britain. I pay particular attention to other nations' experiences with private accounts and note substantial differences between these nations at the time of their reforms and the U.S. of today.

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The fifth chapter explains what "solutions" are no solutions at all. Consider one of these unworkable easy fixes, immigration. Relying on immigration would prove fruitless, since maintaining the current ratio of workers per beneficiary would require a whopping 4.5 to 6 million immigrants every year from now to 2030. And, truth be told, there has been growing political pressure to fence the country off, not made its borders more porous, not to mention the fact that immigrants receive government services in addition to paying taxes.

In the sixth chapter I explain why certain reforms, in my view, would be undesirable. At this point in the work I step beyond observations and into the realm of argument. I cannot say for certain that the solutions I oppose will not work, but I think I present strong evidence to suggest they will not.

Here are two to consider: a hike in the payroll tax rate and raising or lifting the wage cap. Increasing what is already a high marginal tax rate would, among other things, result in a contraction of the labor supply and distort work incentives.

These changes would affect businesses too, since they pay half of the 12.4% payroll tax. Because businesses factor this tax in as an additional cost of hiring labor—that is, the true cost of hiring a worker includes everything from his actual wage to his dental insurance and the payroll taxes on his labor—an increase in taxes would exert downward pressure on wages and employment. Besides, tax hikes lack imagination. It would be a pity if our substantial class of politicians and academics—and, indeed, voters—were so lacking in inventive spirit that it had to resort to a necessary evil when faced with a problem of our own creation.

In the seventh chapter I offer my own reform plan. Here is the very short version:

Reform should, in my view, accomplish seven central goals.

1. Political possibility.

2. Restoration of long-term solvency to the program. This is the reason this whole debate began, after all.

3. Improvement on the efficiency of the current system. Social Security ought not, through the regressive, high marginal tax that is the worker's payroll "contribution," provide the undesirable work incentives it currently does, nor should it be a drag on economic growth, as it is. The opportunity cost of the current system, that is, what we give up to maintain it, namely the return on private capital, is enormous and climbing.

4. Economic security for the elderly.

5. Intragenerational and intergenerational equity. A reformed Social Security system would truly be progressive in its redistribution of wealth; would not penalize blacks and women because of lower longevity and a structure that assumes outdated gender roles, respectively; and would allow the poor, in many cases for the first time, to accumulate wealth across generations. Social Security reform would also head off the coming "fiscal storm" brewing directly between different generations. In the absence of reform, lawmakers would be presented with a stark choice: they could substantially increase the tax burden on the present generation of workers or substantially reduce benefits for a retired generation they and their predecessors had formerly promised to pay in full. Restoring solvency to the system would allow future Congresses to avoid making that choice.

6. Increased national saving, which is low currently in part because of Social Security. It is problematic that workers substitute Social Security "wealth," to which they have no legal right, for actual wealth—assets in the bank.

7. Transparency. This works in two ways, both ensuring that taxpayers know their rights and have a clear understanding of their expected benefits and that Congress is beholden to certain accounting standards.

The program I envision accomplishing these goals has two basic parts. The first is a change in indexation. I would end wage-indexing immediately—that is, begin pegging the initial Social Security benefit to the consumer price index, a measure of inflation, instead of wage growth. The indexing problem is the cause for most of the Social Security shortfall. Of course, upon the introduction of any legislation to do this, a number of congressmen will predictably squawk about a huge benefit cut. But it is simply absurd to suggest that undoing massive increases in *real benefits* is tantamount to a cut. Under current law, I and everyone else my age will enjoy purchasing power some 60% greater than that of current pensioners, simply because of the passage of time.

In this section I also discuss proposals to graduate indexation, such that lower-income workers' benefits would be pegged to wage growth, upper-income workers' benefits would be pegged to price growth, and the indexation of benefits for the middle class would be based on a mix of wages and prices.

The second part of my reform plan is partial privatization, with mandatory accounts financed by the diversion of 6.2 percentage points of the worker's payroll tax. In addition, I incorporate a graduated structure based on age and a guaranteed minimum benefit in order to improve the progressivity of the system—that is, to benefit lower-income seniors.

Then I answer a number of objections to private accounts; consider an abbreviated version of my response to the one most commonly heard objection—that private accounts are too risky.

No plan would allow workers to bet it all on a WorldCom or Enron, so there is no real risk of assets in personal accounts evaporating overnight.

Many who know this still object, saying stocks are too risky for workers and retirees to count on. But the truth is that stocks are remarkably consistent over the long term, with a standard deviation smaller in the long term than even that of bonds. The very worst real return stocks have produced over any thirty-year period was 2.6%. Barring any precipitous drop in equity premia, highly diversified accounts should probably return something like 6.5% per annum.

To further minimize risk, workers would shift from stocks to bonds as they aged. That reversal is part of yet another reason why risk would be small: the participation of so much of the American labor force in these accounts would ensure a steadier and more predictable flow of buyers and sellers. Without reform, retirees, including those in other countries, will, as a group, be selling their assets, while buyers will be relatively few and far between because money will be tight the world over due to pensions concerns.

More importantly, *the risks of the current system are in reality far higher than the risks of a market-based system*. And the risks of the current system are manifold. All workers, especially those with higher mortality, such as minorities, are gambling that they will live longer than the actuarial tables suggest. Not only that, everyone is now gambling on the honesty and good intentions of 535 congressmen. Remember, workers have no legal claim on Social Security benefits. It is hard to imagine, then, a more irresponsible claim than one touting the "guarantee" or "safety" of the current system, which stands atop nothing more than a congressman's fear of touching the killer third rail.

Put differently, Americans should not be weighing a low-yielding but "guaranteed" return against a higher-yielding but "risky" return. They should be weighing an asset against a politician's promise. Under the current system, Social Security benefits are by no means guaranteed, and the probability is high, especially for upper-income workers, that benefits and taxes will change substantially as the years go by. Personal accounts, on the other hand, are just as much off-limits to politicians as 401(k)s or IRAs.

The eighth chapter is my conclusion. I show how Social Security reform would materially transform and benefit a wide variety of groups, including minorities, the poor, women, Congress, and the entire electorate. This last transformation is the most important, because the constituency for sound policy would be greater, the appetite for demagoguery and free lunches smaller, if voters were also savers and investors, rather than merely a cohort of happy-go-luckies expecting the next generation to tax itself to take care of them. Voters would vote more in line with their consumer and investor interests—for free trade and limited regulation, for instance—rather than their producer interests, which currently lead them to support protectionist bunk like steel tariffs and agricultural subsidies.

The great reform debate currently waged in newsprint and on Capitol Hill has focused mostly on how to restore solvency to the system. That's a pity, because our task should instead be to design a system that achieves the goals I outlined earlier. I believe I should instead be to design a system that achieves the goals I outlined earlier. I believe I provide sufficient evidence in my book that a partially privatized system goes a long way toward doing exactly that.