

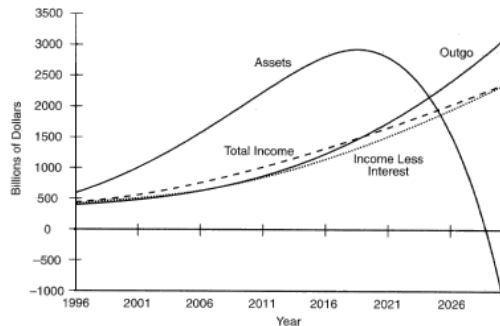
SOCIAL SECURITY: The State Opt Out Solution

98-05

“Only a blind collectivism stands in the way of Social Security privatization,” former Governor William Weld (R-MA).

The Social Security system in the United States is headed for bankruptcy. If there are no changes to the current program, by 2012 (as Baby Boomers begin retiring) Social Security will start to run a deficit. By 2029, Social Security will completely exhaust its assets.ⁱ

Table 1



Unless reformed, Social Security will exhaust its assets by 2029.

How can Social Security go bankrupt? Simply put, it is a pay-as-you-go system in which today’s workers pay for today’s retirees. This system works fine if you have a large number of workers paying for a small number of retirees. Problems arise, though, when the number of workers forced into the system shrinks in relation to the number of retirees drawing out benefits. This is the problem facing Social Security in the next thirty years: As Baby Boomers retire, the relative number of workers in the economy to support them will shrink.

“Wait a minute,” you say, “aren’t the dollars taken out of my paycheck going into an individual trust fund just for me?” Well, that is what government promises lead you to believe. Actually, the government is spending the 12.4% it takes from your

paycheck on its own priorities this year. Meanwhile, it is simply leaving IOUs in the trust fund. Even in this “budget surplus” year, the government is using Social Security funds to mask its operating deficit. Beyond the IOUs, Social Security has an unfunded liability of \$9 trillion, representing the claims of future retirees on the system.ⁱⁱ

Already Opting Out: State and Local Public Employees

A potential solution to the Social Security mess is already at work for some workers throughout the United States. Some six million state and local public employees have been opting out of Social Security for years.ⁱⁱⁱ These select workers are given the choice of opting out of the system in favor of a fully funded, free-market alternative. We need to look no further than our own state to find examples.

Bellevue Mayor Ron Smith, a fiscal conservative, learned to his surprise that the 1,100 employees of his city have the option of participating in a private retirement savings plan (a 401(k) in Bellevue’s case) instead of paying into Social Security. Mayor Smith, a business owner, believed that it was unfair that only public employees were allowed to opt out, while everyone else had no choice but to relinquish 12.4% of their paychecks in Social Security taxes.^{iv}

Mayor Smith’s April 1997 proposal to return Bellevue’s public employees to Social Security did not succeed. Councilman Kurt Springman (like most of the City Council) disagreed with Smith, saying that Bellevue’s system worked fine

and that “at a minimum, we should be considering expanding it to the private sector.”^v *The Seattle Times* called Bellevue’s retirement program a “real world model for...Social Security reform.”^{vi}

Bellevue is not alone in providing its employees with an attractive, fully funded alternative to Social Security. A number of municipalities in the state have similar programs. Some examples in addition to Bellevue are: Edmonds, Federal Way, Kirkland, Mill Creek, Mountlake Terrace, Redmond, and Woodinville. In all, more than 3,550 employees of these eight communities alone have opted out of Social Security.^{vii}

Employees who are allowed to opt out have realized a healthy 13% to 20% in annual earnings on their investment in recent years, gaining 18% in 1997 alone, thereby significantly adding to the quality of life they will enjoy once they retire.^{viii} This rate of return compares well with the profits earned on similar private investment plans that average about 20% annually, although not every year will see earnings this high. Americans forced to pay into Social Security, on the other hand, may see little better than an anemic 2.5% yearly return on their money, barely enough to keep pace with inflation.^{ix} With the impending Social Security crisis, many wonder whether even that much will be available.

Opting Out in Oregon

Searching for alternatives for non-government workers, the Oregon Legislature in May 1997 overwhelmingly passed a resolution sponsored by Senate Majority Leader Gene Derfler -- himself a Social Security recipient -- asking Congress to allow Oregon to opt out of the national Social Security system.

What would Oregonians do if they were given an opt-out waiver by Congress? One plan, presented by Paul Farago of Portland’s Cascade Policy Institute at a Washington Institute Foundation luncheon in March, would first guarantee full benefits to all current and soon-to-be retirees. This would be accomplished by taking Oregon’s fair share of the current Social Security Trust Fund, as well as current and future revenues from the employer portion of Social Security payroll taxes, and pledging them to pay for current retirees.^x

Meanwhile, all current workers in Oregon would set up Oregon Personal Retirement Accounts (OPRAs). The employee portion of the Social Security payroll tax (6.2% of every paycheck) would be deposited in personal, privately administered investment accounts.^{xi} So far, Congress has not responded to this innovative proposal.

Should Washington Opt Out?

A similar resolution to opt out of Social Security has been introduced in Olympia by Rep. Jim Dunn (R-Vancouver), and the idea is under consideration in the legislatures of six other states. State pressure on Congress will add fuel to the fire for urgent Social Security reform. Ultimately, Congress must deal with this issue or the system will go bankrupt. Moving to a fully funded, free-market system would keep the promise to current and soon-to-be retirees, and change the future for today’s workers.

In the meantime, when it comes to the faltering mandatory and financially questionable Social Security scheme, some states are saying, “Let our people go.”

Written and researched by Paul Guppy and Dennis Lisk.

Washington Policy Center is a non-profit, 501(c)(3) research and education organization.

ⁱ Daniel J. Mitchell, *A Brief Guide to Social Security Reform*, p. 3, August 7, 1997, Heritage Foundation, Washington, DC.

ⁱⁱ *Ibid.* p. 2

ⁱⁱⁱ Matt Lathrop, “Congress Eyes State Employee Pension Funds,” ALEC, *FYI Magazine*, March 23, 1998

^{iv} J. Martin McComber, “Bellevue City Council rebuffs mayor on Social Security switch.” *The Seattle Times*, April 15, 1997.

^v Ibid.

^{vi} Unsigned Editorial “Bellevue shows the way to Social Security reform”, *The Seattle Times*, April 21, 1997.

^{vii} Municipal Employees Benefit Trust: The City of Bellevue’s Replacement Program for Social Security, p. 1, The City of Bellevue, WA, January 1, 1997.

^{viii} Email correspondence from Michael Pivec, Benefits Program Administrator, Human Resources Department, City of Bellevue, WA, April 2, 1998.

^{ix} Martin Feldstein, “Time to Privatize Social Security,” *The Wall Street Journal*, March 8, 1996.

^x Randall J. Pozdena, Ph.D., “The New Oregon Option: Opting Out of Social Security - Saving Oregonians from the Inevitable Disintegration of Social Security,” Policy Insight No. 103, p. 15, Cascade Policy Institute, Portland, OR, July 1997.

^{xi} Ibid. p. 15.