Perspective: Social Security in the 21st Century

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SOCIAL SECURITY IN THE 21ST CENTURY
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From our perspective in 1996, it is challenging to imagine what the world will be like in 2096.

For example, in the United States in 1896, almost no one could have imagined that a hundred years hence in 1996, less than two percent of the labor force would be employed in agriculture. If someone had made such a prediction, he or she would have been ridiculed as wildly imaginative and unrealistic.

This example is useful because it seems quite possible that, by 2096, less than two percent of the US labor force will be employed in industrial production -- and the same may be true for Mexico and every other country as well. This prediction may be perceived as unrealistic by many people. Yet, there is reason to believe that changes of historic magnitude are underway.

Just as the agricultural era gave way to the industrial era, the industrial era is now giving way to the information era. Moreover, it seems likely that the information revolution will occur more rapidly and be more global in scope than the industrial revolution. Already, for example, there are internet connections to impoverished rural villages in India that were virtually untouched by the industrial age. Within a few decades, it is possible, even likely, that almost the entire world will be electronically interconnected.

We are on the front end of a massive technological transformation and the implications are astounding. Of particular interest in this symposium, the information revolution will profoundly alter the way in which we perceive and carry out social security policy.

The underlying theme in my comments today is that, in the long-term, the following simple relationships are dominant:

- Technology shapes economic organization.
• Economic organization shapes social issues.
• Social issues shape policy responses of the state.

These are certainly not new observations. These simple relationships have been underlying themes of the great economic and social thinkers of the last century, especially Karl Marx and Max Weber, and a wide range of economists, sociologists, and policy analysts in this century.

As information technology reshapes economic organization, we will live through major -- and often chaotic -- social changes. These will, in turn, dramatically reshape social security policy.

The thinking and solutions of yesterday will not be applicable in the world as it is now unfolding.

SOCIAL SECURITY IN THE 20TH CENTURY: A CREATION OF INDUSTRIALISM

Looking back, the industrial era has been a "mass" era. We have assumed that a mass society can be sustained in low skill employment that is essentially stable over the long term. At the household level, the assumption is that most people will have a long-term job, and social security policy will, as necessary, supplement the income from this job.

In the industrial era, the basic idea of domestic policy has been to have an industrial economy that is productive enough so that it can be taxed to provide income -- which is assumed to be roughly equivalent to consumption -- for groups who do not receive sufficient income from the market economy. These groups typically include the retired, the disabled, the unemployed, dependent children, and sometimes others.

Direct income support is the primary policy strategy of the twentieth century welfare state. Not every country has had the same policies, but the overall pattern has been that social insurance is the dominant mechanism. (It might be added that what is called "social insurance" is often not true insurance because the total benefits paid often far exceed the total premiums collected. In other words, the "insurance" benefits are in large part a welfare transfer from general revenues.) A variety of other income-based mechanisms also occur. The most common are social allowances (demogrants), social assistance (means-tested transfers), and tax incentives for occupational welfare provisions.
The choice of social insurance as the dominant social security policy in the twentieth century is derived from certain assumptions and perspectives concerning industrialism and low skill mass production:

- **Economies and labor markets are essentially closed and tied to nation states.** Therefore it makes sense to think exclusively in terms of national social policies that serve a nation’s population.

- **Social and economic issues are and should be almost completely separate.** Indeed, the two are viewed as conflicting because resources are drawn away from production for individual and household consumption.

- **There is a preoccupation with mass problems and deficiencies, or "needs."** These mass needs are addressed via categorical programs, which are centralized and operate as bureaucratic organizations. Bureaucracy is also a creation of the industrial era.

- **The non-employed require only income support when they are not earning labor income.** In this regard, unemployment insurance is the epitome of industrial-era social security thinking: it provides income support with little emphasis on retraining for new employment. The assumption is that any unemployed person can take the next low skill job that is available.

- **Retirement is a fixed period of inactivity late in life, a reward for several decades of hard physical labor.** In fact, mass retirement was created by industrialism and the social policies that accompanied it. Prior to industrialism, most people worked until they were no longer able to do so.

**An Assessment of Social Security Policy**

The twentieth century welfare state was a remarkable and successful social innovation in its time. During the heyday of the industrial era, the welfare state was a triumph of caring over indifference, lifting millions of people, especially the elderly, out of poverty. But industrial era policies were not perfect, and time does not stand still. As the economy and social conditions change, income-based social policy is less and less functional to the world we live in. Several general criticisms can be made about social security systems in the world today:

- **In terms of social protections, most social security systems have not been very progressive.** The welfare state has largely served the middle class, while the poor have been second class participants. This is particularly true in Latin America, where social security systems have tended to serve
primarily the unionized labor force. A related point is that mass organized labor, which is also a feature of the industrial era, has not been deeply concerned about the conditions of the poor. To be sure, organized labor uses social justice rhetoric, but its actions tend to be on behalf of better-paid workers. To take a recent example, the 1995 French strike over reductions in welfare benefits was primarily on behalf of government workers seeking to protect their comfortable state pensions. No one was striking on behalf of the poor.

- **Income-based policy functions as a massive consumption promoter.** The policy is designed almost exclusively to support consumption rather than savings. The macroeconomic effect is reduced domestic savings, reduced investment, and resulting slower growth and dependence on foreign capital.

- **Centralized cash payments in social security policy tend to undermine intra-family and community support,** not only in traditional societies, but in industrial nations as well. This "conservative" critique is essentially correct, but is often unacknowledged by progressive policy analysts.

- **There are national boundary problems in an increasingly global economy.** For example, to integrate the economies of the European Community (EC), labor migration and social security policy present major challenges. At present, large-scale labor migration from one country to another is unlikely because the EC has failed to harmonize social benefits from one country to another. Social security conditions differ so widely that they are a major impediment to mobility in a unified labor market.

- **Most social insurance systems today face serious fiscal problems.** Pronounced demographic changes -- the growing elderly population and declining birth rate -- render almost all pay-as-you-go social insurance policies unsustainable in their current form (Japan is a notable exception, due to rather impressive long-term planning). Fiscal crises have already occurred in many countries and are looming in others.

**WORLD WIDE TRENDS IN SOCIAL POLICY**

In response to these strains, traditional welfare state policy has begun to change in the last years of the twentieth century. Trends in the world are as follows:
• *Reductions in means-tested support for the poor.* This has occurred largely because spending for the poor is politically the easiest to cut. In this regard, it is ironic that relatively generous social insurance payments to the middle class are so often defended on grounds of solidarity and social justice, while the fiscal strain created by these entitlements often leads to reductions in spending on the poor.

• *A weakening in the dominance of defined-benefit social insurance.* As fiscal strain increases, nations are turning to other forms of social protection to complement social insurance.

• *More mixed systems or multiple pillars in social security policy,* as recommended in the 1994 report by the World Bank.

• *A rise in the use of asset-based policy in the form of asset accounts.* These accounts are typically facilitated by public tax incentives for household savings. Several trends suggest that the emergence of this policy mechanism is widespread: (1) The success of national provident funds in Singapore and Malaysia has influenced development of provident funds in the Pacific Islands and is likely to have a major influence in Chinese social security policy. (2) The Chilean experience with privatized asset accounts is being copied to some extent by Argentina, Peru, Colombia, and several other Latin American countries. The Chilean example is also a major influence on coming policy changes in Mexico. (3) In the United States, we see a pronounced shift to defined contribution systems in the private sector; increasing proposals to make part of Social Security retirement a defined contribution system; and movement toward asset accumulation by the poor by raising means-tested asset limits and creating Individual Development Accounts (IDAs), which are matched savings accounts for home owning, education, microenterprise, and other development purposes.

**ECONOMIC AND SOCIAL CHANGES THAT ARE LIKELY TO ACCOMPANY THE INFORMATION REVOLUTION**

It is impossible to know exactly what economic and social conditions will be like by the end of the next century, but the following seem likely:

• *A more global economy, with stronger transnational ties -- commercial, political, and social -- and a decline in the influence of nation-states.*

• *Less mass employment,* with more specialization and production by small firms.
• **Less stable employment**, with more temporary work and frequent job changes.

• **Ever greater labor skill requirements**, with continual changes in demand for human capital, and a concomitant reduction in demand for unskilled and low skilled physical labor.

• **Greater geographic mobility of workers**, including mobility across national borders.

• **More workers who are essentially entrepreneurs selling their talents in the marketplace.**

• **Household income from more varied sources**, combinations of "regular" employment, temporary employment, entrepreneurial activity, and asset earnings. Just as many impoverished households today "patch" income from multiple sources to survive, the middle class will be more likely to do so tomorrow.

• **Worklife not as rigidly confined by location, daily hours, or period in the life span.** There will be more variation, more gradualism, and more transitions in and out of the labor market over the life cycle.

• **Individuals and households in more divergent circumstances with many divergent "needs,"** as opposed to mass needs defined by mass labor markets.

• **People living longer, and more people who are healthy and capable in their older years.**

• **Retirement largely redefined** as a less definite stage in the life cycle, with greater emphasis on social engagement and economic productivity during the older years. The elderly will engage in a mix of productive activities -- including paid labor, entrepreneurship, caretaking of family members, community volunteering, and civic involvement -- in addition to retirement leisure.

**SOCIAL SECURITY IN THE 21ST CENTURY**

Three Major Goals
Social security policy in the twenty-first century is likely to have three major goals, equally emphasized:

- **Social protection goals** to buffer hardship and promote social stability. This has been the primary (almost exclusive) theme of twentieth century welfare states, and it should certainly be retained in the twenty-first century. The focus is on standard of living, coverage and adequacy, and minimum protections at the bottom. Social welfare is defined in terms of income and consumption.

- **Household development goals**. Consumption is not enough. Domestic policy should promote economic and social development of households, empowering citizens and promoting active participation in work, family and community life, and civic affairs. At the household level, development goals will be as important as social protection goals in social security policy.

- **Macroeconomic goals**. As is now apparent to almost everyone, it is insufficient to think merely in terms of households. Policy-makers must also consider the macroeconomic goals of savings and investment, a strong and stable currency, development of securities markets, and economic growth.

In a word, twenty-first century social security policy will move beyond consumption, aiming for greater development of households, communities, and societies.

**Continuing Shift toward Asset-Based Policy**

As defined benefit social insurance systems come under increasing fiscal pressure, they will be augmented, and in some cases largely replaced by, defined contribution systems. Indeed, by the middle of the twenty-first century, I would anticipate that social insurance will no longer the dominant pillar in social security policy in most countries. It will have been replaced by asset accounts.

This policy shift is consistent with Jeffersonian themes of property owning and democracy in the United States. It is also consistent with Lee Kuan Yew’s goal of making Singaporeans home owners so they will be more strongly committed to the nation. Considerable empirical research documents positive economic, psychological, and social effects of asset holding in many different countries and cultures. Effects of asset holding include longer time horizons, greater work effort, more involvement in the community, more stable family life, and better outcomes for children. In other words, the value of assets is far greater than their value as a storehouse for future consumption. Assets yield positive social and civic returns.
At the macroeconomic level, markets do not always get everything right, and one area where markets require assistance from public policy is in generating savings. It is clear from examples such as Singapore and Chile that domestic policy based on asset accumulation can make enormous contributions to rates of internal savings and economic growth. In the twenty-first century, we will not think exclusively in terms of social protections at the expense of economic growth. We will instead think of social protections and economic growth. In this regard, the 1994 World Bank report on social security will likely be viewed as a seminal document in the transition from income-based policy to asset-based policy.

Changes toward asset-based policy are happening with a speed that is almost breathtaking by the normally deliberate standards of social policy reform. To take a case in point, a few years ago in 1993, I had the privilege of attending a policy discussion to prepare a report for Donaldo Luis Colosio, who was at the time the likely PRI candidate for the Mexican Presidency. One of the major proposals then under consideration was to implement unemployment insurance as the next “piece” of Mexican social security policy. Coming from research in Singapore at the time, I was skeptical about this proposal for unemployment insurance, especially knowing that it would be unlikely to benefit people at the bottom, and I counseled instead for a greater emphasis on asset accounts for all Mexicans. People listened politely, but little attention was paid to this suggestion at the time. It is a measure of how much the policy debate has changed that in this 1996 symposium unemployment insurance will be little discussed, and asset accounts will be the central consideration.

**A Vision of Social Security in the 21st Century**

What would be the characteristics of a successful social security policy in the twenty-first century?

**Overall policy themes**

- Social policy would be more integrated with economic policy.
- Policy would aim for full funding rather than pay-as-you-go.
- The policy system could adapt to a wide range of different social and economic issues within the same basic structure.
• Individual accounts would be the dominant domestic policy instrument.

• Accounts would operate on principles of defined contribution rather than defined benefit.

• Accounts balances would be fully vested and fully portable.

• A range of investment options would be available, encouraging competition for market rates of return.

Coverage

• Everyone would be included in the primary asset-based system.

• Accounts would be established beginning at birth.

Funding

• Mandatory and work-related contributions would be the main funding source.

• There would be deposit subsidies for the non-employed or under-employed. For example, if the state provided tax incentives to build accounts of the non-poor, the state would also as a matter of fairness provide a similar amount in direct deposit subsidies to build accounts of the poor.

• Policy would encourage creative, entrepreneurial partnerships to fund accounts for the poor, with a variety of citizen, family, corporate, civil society, state, and international partnerships.

Social Fabric

• To every possible extent, intra-family support would be encouraged in building and using asset accounts. This would somewhat reduce government costs and also to strengthen the family unit.

• To every possible extent, there would be incentives for community participation in building accounts, to strengthen rather than weaken traditional community ties.

Integration, Choice, and Flexibility
Eventually asset accounts would be used not only for retirement security, but also for housing, education, health care, insurances, investments, and other domestic policy purposes. The boundary between social and economic policy would largely disappear at the household level.

The policy would facilitate household control of policy choices. In effect, households would make their own policy decisions rather than be subject to strictures of bureaucratic programs.

At the institutional level, a great deal of policy would be integrated into a single system, obviating the need for multiple and uncoordinated categorical programs.

The policy structure would be simple and flexible, with new uses of accounts made available as capital accumulates over time.

Management

The asset-based policy system would be defined and regulated by government.

But investments would be managed in the private sector.

International Social Policy

International agreements would make accounts portable across national borders.

Gradually, a universal worldwide system of social policy would be created, with multiple interlocking bilateral and multilateral agreements. This new system might be called the Global Security and Development Fund.

Supplements

The primary asset-based system would be supplemented by direct social provisions, particularly in education and primary health care, insurances to protect against depletion of asset accounts, and back-up means-tested provisions as a minimum floor or safety net for the poor.

Concerns in Asset-Based Social Security
As indicated above, there will in all likelihood be a shift toward asset-based policy in the next century, and in fact it is already occurring. But the vision of asset-based policy that I have presented in these comments is highly idealized. It is what would be most desirable. In reality, no policy system is perfect, and there is a possibility, even likelihood, of major deviations from what I have suggested. Indeed, there are a number of reasons to be wary of the shift to asset accounts. Permit me to mention three major concerns.

**Coverage and adequacy.** A key issue is whether progressive principles are possible in a defined contribution system. How can we ensure principles of inclusion, solidarity, and progressivity in a system of social security based on asset accumulation?

The shift to asset-based policy could occur but leave many people behind, excluded from the system. In this regard, asset accounts could be even more regressive than social insurance. Indeed, this outcome is likely in many of the reforms that are now taking place in Latin America. If the shift to asset accounts is to be successful in the long run, extraordinary efforts must be made to bring everyone into the primary asset-based policy system.

This will require, as a first step, the creation of accounts for all citizens at the youngest possible age. In this regard, the innovative proposal of Professor Clemente Ruiz Duran for “citizens accounts” deserves special consideration. Once such accounts are in place, a wide range of creative funding strategies can be developed to build assets of the poor. This would be a redistribution "up front" in a savings system so that people can invest in themselves and become more productive.

**Protection of funds.** Another major concern is the protection of funds that individuals have saved and invested. For most countries, the best strategy will be to use financial markets for investments, as in the Chilean model. The simple reason is that, unfortunately, there are very few governments in the world who are capable of managing tens or hundreds of billions of dollars over the long term without spending or depleting the resources in one way or another.

On the other hand, care must be taken to ensure protection of funds in private security markets, particularly where these markets may not be fully developed. The infusion of funds from an asset-based social security system can be a major vehicle for building financial markets, but until those markets are reliable and efficient, the government must play a major oversight role.

**Implications for freedom and democracy.** Because Singapore and Chile are the world’s most extensive examples of asset-based policy, a question naturally arises about the role of authoritarianism in a defined contribution social security
system. Some have argued that only in an authoritarian regime is it possible to shift to mandatory savings on a large scale.

This is a valid concern, but it applies only to implementation. Big policy changes of any kind are more challenging in a democracy. That is, in many respects, the strength of democracy.

Regarding compulsory savings, mandatory contributions in social security have a well-established history in all the major democracies in the world. The only difference in an asset-based system would be that the payments go into a defined contribution rather than a defined benefit system.

Once implemented, a defined contribution social security system is entirely consistent with democratic principles. Individual accounts give greater individual control and enable families to have a strong "voice" in their own social policy decisions.

**CONCLUSION**

Mexico, like several other nations in Latin America, is undertaking a major change to asset accounts in social security policy. The transition will be challenging and at times chaotic, but the positive potential for Mexican households and for the nation as a whole is very great. This policy will be more adaptive to the economic and social conditions of the twenty-first century. In this regard, Mexico will be the leading example in North America.

After Mexico has established asset accounts in social security, it may serve as a model for planning a regional social security policy wherein workers can move freely across national borders, making deposits into their accounts regardless of what country they work in. This would be the social policy equivalent of NAFTA, an integration of markets to increase efficiency in transactions. It would also greatly increase security and quality of life for many workers.

This will in all likelihood be the basic domestic policy strategy of the next century. As the twentieth century has been a century of welfare states, the twenty-first will be a century of investment states, and the major vehicle for asset accumulation at the household level will be specialized personal accounts, which will replace much of what we now think of as social security policy.