TIERNEY ON CHILE'S PENSION SYSTEM

(Three columns by John Tierney, Op Ed columnist of The New York Times)

I. THE PROOF IS IN THE PENSION (April 26, 2005).

SANTIAGO, Chile. I made a pilgrimage to Santiago seeking to resolve the Social Security debate with a simple question: What would Pablo Serra do?

I wanted to compare our pensions to see the results of an accidental experiment that began in 1961, when he and I were friends in second grade at a school in Chile. He remained in Chile and became the test subject; I returned to America as the control group.

By the time we finished college, both of our countries' pension systems were going broke. Chile responded by pioneering a system of private accounts in 1981. America rescued its traditional system in the early 1980's by cutting benefits and raising taxes, with the promise that the extra money would go into a trust to finance the baby boomers' retirement.

As it happened, our countries have required our employers to set aside roughly the same portion of our income, a little over 12 percent, which pays for disability insurance as well as the pension program. It also covers, in Pablo's case, the fees charged by the mutual-fund company managing his money.

I visited Pablo, who grew up to become an economist, at his office at the University of Chile and showed him my most recent letter from the Social Security Administration listing my history of earnings and projected pension. Pablo called up his account on his computer and studied the projected retirement options for him, which assume that he'll keep working until age 65 and that the fund will get an annual return of 5 percent (which is lower than its historical average).

After comparing our relative payments to our pension systems (since salaries are higher in America, I had contributed more), we extrapolated what would have happened if I'd put my money into Pablo's mutual fund instead of the Social Security trust fund. We came up with three projections for my old age, each one offering a pension that, like Social Security's, would be indexed to compensate for inflation:

(1) Retire in 10 years, at age 62, with an annual pension of $55,000. That would be more than triple the $18,000 I can expect from Social Security at that age.

(2) Retire at age 65 with an annual pension of $70,000. That would be almost triple the $25,000 pension promised by Social Security starting a year later, at age 66.

(3)Retire at age 65 with an annual pension of $53,000 and a one-time cash payment of $223,000.

You may suspect that Pablo has prospered only because he's a sophisticated investor, but he simply put his money into one of the most popular mutual funds. He has more money in it than most Chileans because his salary is above average, but lower-paid workers who contributed to that fund for the same period of time would be in relatively good shape, too, because their projected pension would amount to more than 90 percent of their salaries.

By contrast, Social Security replaces less than 60 percent of your salary - and that's only if you were a low-income worker. Typical recipients get back less than half of their salaries.

The biggest problem in Chile is that many workers don't contribute regularly to their pensions because they're unemployed or working off the books. That's a common situation in the developing world, no matter what the pension system is. But if you contribute for at least 20 years, Chile guarantees you a minimum pension that, relative to the median salary, is actually more generous than the median Social Security check.

Still, you may argue, Chileans may someday long for a system like Social Security if the stock market crashes and takes their pensions down with it. The relative risks of the Chilean and American systems are a question for another column. But I can tell you that Pablo is an economist who appreciates the risks of stocks and has no doubt about where he wants to keep putting his money.

"I'm very happy with my account," he said to me after comparing our pensions. He was kind enough not to gloat. When I enviously suggested that he could expect not only a much heftier pension than mine, but also enough cash to buy himself a vacation home at the shore or in the country, he reassured me that it would pay for only a modest place.

I'm not sure how much consolation that is, but I'm trying to look at the bright side. Maybe my Social Security check will cover the airfare to visit

bright side. Maybe my Social Security check will cover the airfare to visit him.

2. PLACE YOUR BETS (May 7, 2005)

After a recent column comparing Social Security with the Chilean system of private accounts, I was deluged with letters from readers eager to explain why I am a superficial nitwit. In this case, they're at least half right.

The column was superficial because I simply looked at how much more money I'd have if I had invested my Social Security contributions in the private account of a Chilean friend and economist, Pablo Serra. The numbers were impressive - my projected pension would be triple what I'm promised by Social Security - but they're not as important as another consideration: which type of pension is riskier?

Pablo has done well because Chilean mutual funds have yielded high returns in the past two decades - probably higher than I would have gotten from an American mutual fund, although here I'd still be way ahead of Social Security. Historically, stocks have yielded returns two to three times what Social Security pays.

Still, stocks could yield much lower returns in the future, as critics of private accounts have pointed out in advertisements comparing the market to a slot machine and extolling the "guarantee" of Social Security.

But there's also another kind of risk to consider, one that Chilean workers kept mentioning to me. The best part of their private accounts, they said, was that they'd put "la plata donde mis ojos la vean" - the money where my eyes can see it. They knew they might lose some of it in the stock market, but they preferred that to watching it all disappear into politicians' hands.

My Social Security, far from being a guarantee, comes with a political risk that will become clear around 2017, when I'll be 64. That's when the Social Security Administration expects to start paying out more than it collects in taxes.

In theory, there is a trust fund to cover this shortfall. When Congress sharply raised Social Security taxes in the 1980's, the idea was to generate surpluses during the baby boomers' working years that would finance our retirement. Instead, Congress spent our money, leaving the Social Security trust fund with a file cabinet full of i.o.u.'s in the form of Treasury bills.

It's not a problem now, because for the next few years the baby boomers' taxes will provide an annual surplus for Social Security of about $100 billion, allowing Congress to dole out the extra money for its favorite causes, like farm subsidies and weapon systems and West Virginia buildings named after Robert Byrd. But in four years the surpluses start declining, and they turn into deficits around 2017, when Congress must begin repaying those i.o.u.'s.

By the time I'm in my 70's, the Social Security shortfall will force Congress to find new taxes or make spending cuts that are more than half the size of the Pentagon's budget. If I make it to age 88, there will no more i.o.u.'s left in the trust fund, so everyone's benefits would have to be cut by 27 percent.

Faced with the grim math, President Bush offered a progressive compromise last week to Democrats: protect the poor while moderating the growth of benefits for higher-income workers. Democrats refused to bite, denouncing his "cuts" without offering a plan of their own, and members of both parties wondered why any politician would jeopardize his party's chances in 2006 by tackling an unpleasant future problem.

You can call the Democrats irresponsible obstructionists, but they're just following the first rule of politics: get re-elected. It's the same rule followed by the politicians from both parties who have spent the baby boomers' retirement money. Why set aside money for 2017 if it could be used to woo voters and campaign contributors for the next election?

I can't protect my pension against political risk, but Pablo can help protect his against the risks of the stock market. As he approaches retirement, he can gradually shift his money out of stocks and into bonds, like the ones that financed the private road between Santiago and the port city of Valparaiso, which will be paid off by tolls. The Chilean pension system has billboards along the road proclaiming, "Your savings are financing this highway, and this highway is financing your retirement."

Those billboards have been on my mind. My pension depends on 535 politicians who will be asked to vote for steep tax increases or budget cuts that they fear could cost them their jobs. Pablo's pension depends on people driving between Chile's two largest cities.

III. THE OLD AND THE RESTED (June 14, 2005)

Men in their 70's raced on bikes for 40 kilometers in this month's National Senior Games in Pittsburgh. A 68-year-old woman threw the discus 85 feet, and a 69-year-old man hurled the javelin nearly half the length of a football field.

Is it possible that people this age are still physically capable of putting in a full day's work at the office?

I realize I'm being impolitic. In the Social Security debate, the notion of raising the retirement age is the elephant in the room, as Robin Toner and David Rosenbaum reported in The Times on Sunday. Both liberal and conservative economists favor the change, but politicians are terrified to even mention it to voters.

Americans now feel entitled to spend nearly a third of their adult lives in retirement. Their jobs are less physically demanding than their parents' were, but they're retiring younger and typically start collecting Social Security by age 62. Most could keep working - fewer than 10 percent of people 65 to 75 are in poor health - but, like Bartleby the Scrivener, they prefer not to.

The problem isn't that Americans have gotten intrinsically lazier. They're just responding to a wonderfully intentioned system that in practice promotes greed and sloth. Social Security is widely thought of as a kumbaya program that unites Americans in caring for the elderly, but it actually creates ugly political battles among generations.

With the help of groups like AARP, the elderly have learned to fight for the right to retire earlier and get bigger benefits than the previous generation - all financed by making succeeding generations pay higher taxes than they ever did themselves.

The result is a system that burdens the young and creates perverse incentives for people to retire when they're still middle-aged. Once you've worked 35 years, more work often yields only a tiny increase in your benefits (sometimes none at all), but you still have to keep paying the onerous Social Security tax, which has more than doubled over the last half century.

If the elderly were willing to work longer, there would be lower taxes on everyone and fewer struggling young families. There would be more national wealth and tax revenue available to help the needy, including people no longer able to work as well as the many elderly below the poverty line because they get so little Social Security.

Getting that kind of system seems politically hopeless at the moment here, but it already exists in Chile. Its pension system has a stronger safety net for the older poor than America's (relative to each country's wages) and more incentives for people to work, because Chileans' contributions go directly into their own private accounts instead of a common pool like Social Security.

Once Chileans accumulate enough money in the account to finance a pension that pays at least half their salary (which is better than what the typical American gets from Social Security), they can start collecting the pension and still go on working. In fact, they have an extra incentive to go on working because they keep more of their paychecks: elderly Chileans, unlike Americans, are freed of the obligation to continue making pension contributions.

The result has been a big change in working habits. Before the private-account system began in 1981, Chile had a traditional pension system going broke with the same problems as America and Europe: rising taxes on the young to pay for older workers who were retiring earlier and earlier. But under the new system, there's been a 30 percent increase in the labor force participation by workers in their 60's, according to two economists, Estelle James and Alejandra Cox Edwards.

Best of all, Chileans who control their own private-account pensions don't have to count on politicians or groups like AARP to decide when they can retire. It's a personal choice, not a public battle, and the Chileans I interviewed had a saner attitude about retirement than the American baby boomers dreaming of retiring to decades of golf.

A 57-year-old schoolteacher, Maria Clara Meyer, told me she was thinking of spending her 60's running her own tutoring program or setting up an ecotourism business in Chile. "I'm a little tired of my teaching job," she said, "but I'm not stupid, so I shall keep doing something. It's not healthy for you to stop working if you're still able." And not healthy for your country, either.

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