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## Commentary

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# COMMENTARY

## COMMENTARY ON PRESENTATIONS OF PROF. ROBERTA S. KARMEL & PROF. JAMES A. FANTO\*

*Gregory S. Alexander*<sup>†</sup>

Okay. It's Friday afternoon, getting very close to 4:00. This is the last panel of this two day conference. I think I understand my role. I will be brief.

Roberta Karmel and Jim Fanto were very wise to choose me as one of the commentators at this point because as I suspect they knew, I have little, if any, great interest or value to add to these two valuable papers. I have just three observations to make, and I will make them briefly. I promise.

The first is that "Social Security privatization" is an oxymoron, or put somewhat differently, "there is no escaping the state." Here, I am completely agreeing with Morton Klevan's comments earlier. Roberta's paper is particularly valuable in this respect pointing out in a wonderful survey the variety of ways in which Social Security privatization inevitably entails a great deal of state involvement not only because it is state-initiated and state-implemented, but because it may ultimately lead to greater state supervisory or regulatory control. Now, one does not have to be a great admirer of the state to think that this is so.

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Quoting from Richard Posner's recent book, *Aging and Old Age*, (I take it that we can all stipulate that Judge Posner is no unabashed apologist for the state), "if social security were replaced by a law that 'simply' required people to save for their old age, something like ERISA would be necessary to make the law more than an empty gesture."

My second observation is one that follows up on Jim Fanto's very interesting paper, focusing as it does on the role of norms. The ultimate political success of Social Security privatization depends on investor norms. That seems absolutely clear to me. However, I am not simply speaking of norms of investor education but of norms of trust as well. Here, the role of institutions—which institutions become more powerful, achieve a more paramount position—is crucial. The questions are in what situations, and in which institutions, is trust more likely to exist. Institutions of the state alone? Institutions such as investment advisors, investment managers, life insurance companies and the like? A closely related question is in which institutions is the trust warranted? And, finally, are the answers to these two questions going to be the same?

Closely following up on that point is my third observation, which is that the decision whether participation should be in the kind of scheme we currently have, a pay-as-you-go system completely controlled by the state, or through some sort of private individual account system inevitably indicates what form of individual account system individuation will take. Specifically, what I have in mind is what is the appropriate degree of control the individual employee will, or should, have over the assets that he or she is saving?

Jeff Gordon's comments earlier this morning were particularly valuable in this respect, focusing as they did on the fact that we are engaging in stage four planning. I think that is precisely what we are talking about here. Moreover, as I think Jeff very accurately pointed out, Bob Clark may have been guessing wrong when he predicted that stage four would involve, in effect, the rise of, or the increasing degree of passivity on the part of, employee savers through, for example, defined benefit plans rather than defined contribution plans.

Since Bob's paper was written, we have certainly seen some evidence of a trend away from defined benefit plans and toward defined contribution plans.

Jeff made a very strong case for defined benefit plans, and I am in no position to disagree with that at all. It does seem to me, though, that there may be a case to be made for a defined contribution plan or something which involves more employee participant control over the saved assets. The case I have in mind would be based on the level of trust that the public has in whatever scheme is going to replace Social Security. Let us distinguish between active and passive investment not in the way in which Deborah Weiss defined it, which I took to mean basically the distinction between investments in index fund versus fund managers picking and choosing, but rather in terms of the degree of control that the individual participant has over the use of his or her account.

Passive investment is one that follows the traditional trust law model, vesting virtually all control, albeit in a fiduciary capacity, to some intermediary. Active ownership is an arrangement that reverses Dean Clark's historical trend by gradually conflating the distinction between beneficial ownership and control. The beneficial owner has greater control over precisely how his or her saved assets are used, rather than being entirely dependent upon the expertise of investment managers or advisors.

I think it is arguable that the public will have greater trust in a system that gives the individual a greater voice in the management and use of what is, after all, his or her property. This may be so despite the fact that greater control carries with it greater risks. In other words, I am suggesting that, paradoxically, the more trusted forms of retirement asset management may be those that are riskier. The reason is that greater self-control gives the owner a stronger sense of security. I do not have time to elaborate on this idea here, so I will stop at this point.

