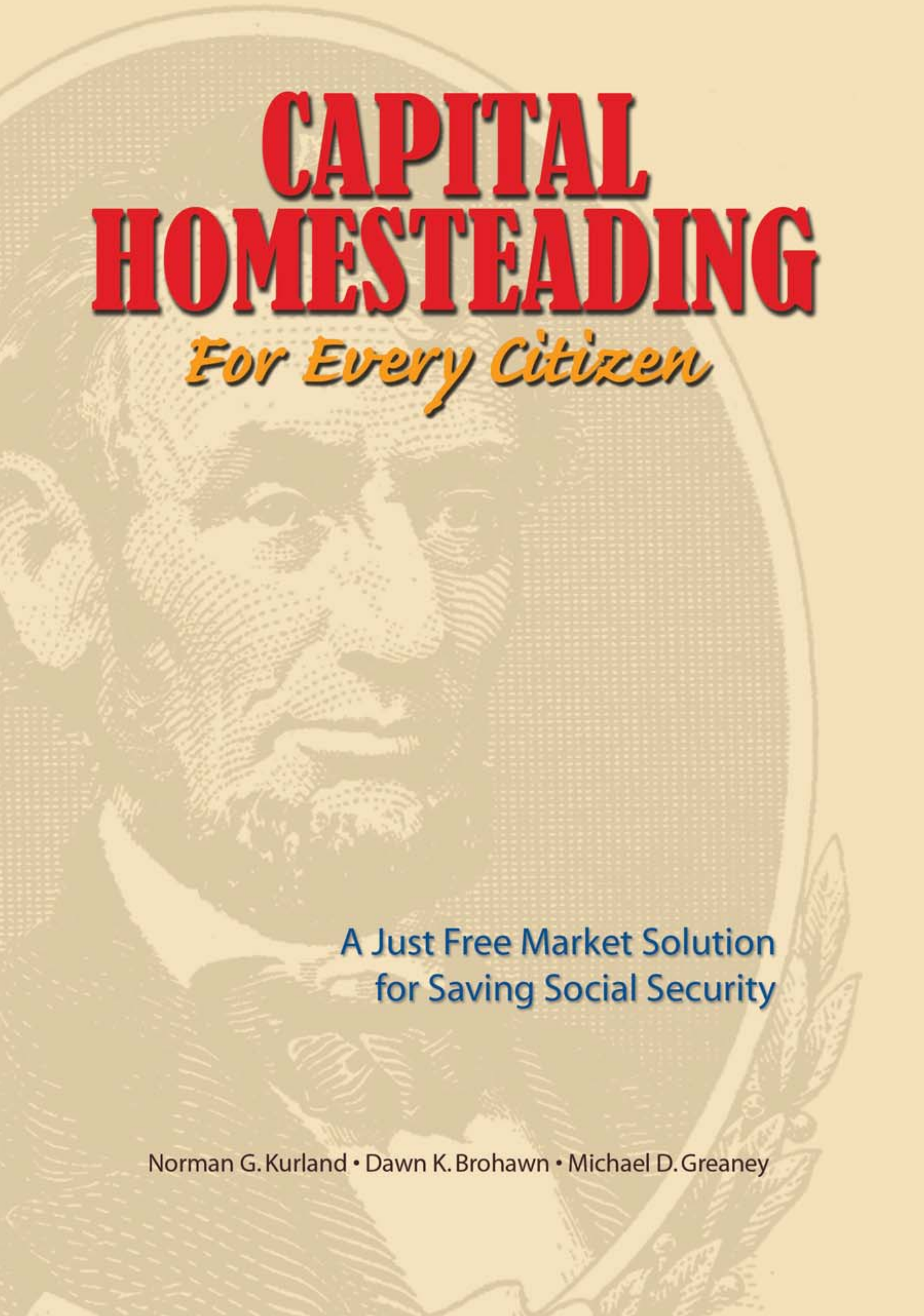

CAPITAL HOMESTEADING

For Every Citizen

A Just Free Market Solution for Saving Social Security

Norman G. Kurland • Dawn K. Brohawn • Michael D. Greaney

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"All men are by nature equally free and independent, and have certain inherent rights, of which they cannot, by any compact, deprive or divest their posterity; namely, the enjoyment of life and liberty, *with the means of acquiring and possessing property*, and pursuing and obtaining happiness and safety."

George Mason
("Father of the American Bill of Rights")
Article 1 of the *Virginia Declaration of Rights*,
adopted June 12, 1776

★

"Power naturally and necessarily follows property."

Daniel Webster
Address, Massachusetts Convention, 1820

★

"I take it that it is best for all to leave each man free to acquire property as fast as he can. Some will get wealthy. I don't believe in a law to prevent a man from getting rich; it would do more harm than good. So while we do not propose any war against capital, we do wish to allow the humblest man an equal chance to get rich with everybody else."

Abraham Lincoln
Campaign Speech in New Haven, March 6, 1860

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"Over one hundred years ago, Abraham Lincoln signed the Homestead Act. There was a wide distribution of land and they didn't confiscate anyone's already owned land. They did not take from those who owned and give to others who did not own. We need an Industrial Homestead Act."

> Ronald Reagan
> Speech to the Young Americans for Freedom, July 1974

★

"Tax policy alone may not be adequate if expanded ownership is ever to become a reality. It seems to me that we will have to do something on a monetary side as well and I am speaking here in terms of using the government powers through the Federal Reserve Bank and others to see to it that loans are made available on more reasonable terms that help workers acquire capital."

> Senator Russell B. Long
> (Longtime chairman of the Senate Finance Committee and political champion of the Employee Stock Ownership Plan)
> Keynote address at Harvard University, April 17, 1982

★

"[The challenge is] to make the world work for 100% of humanity in the shortest possible time through spontaneous cooperation without ecological offense or the disadvantage of anyone."

> Buckminster Fuller
> (Philosopher, world design scientist and inventor of the geodesic dome)
> Attributed to *The World Game,* mid-1970s

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EXECUTIVE SUMMARY

- The proposed Capital Homestead program would offer a private property and free market oriented alternative for saving the Social Security System as a national retirement income maintenance plan, while introducing a new national policy to foster "capital self-sufficiency" as a means to achieve true economic independence for all Americans.
- Following the precedent of Abraham Lincoln's Homestead Act of 1862 that democratized the ownership of frontier land, this economic policy would universalize access to capital credit — the 21st century equivalent of the 160 acres of land — to every citizen. This would provide access to the means for every citizen to accumulate over his or her lifetime an independent income-producing capital homestead in the ever-expanding technological frontier.
- Based on four pillars of a free and just market economy — (1) expanded capital ownership, (2) limited economic power of the state, (3) restoration of free and open markets, and (4) restoration of the rights of private property — the Capital Homestead program would strengthen the political constituency for linking supply-side with demand-side economic policies. It would add social justice and compassion to conservative principles. It would also reduce the political pressures for redistributive, anti-growth and protectionist policies.
- Capital Homesteading would introduce basic reforms in the monetary and tax systems, geared toward maximizing private sector growth without inflation, shifting from a debt-backed to an asset-backed currency, while systematically building a nation of owners.
- Capital Homesteading would reduce pressures on the present pay-as-you-go Social Security and Medicare systems, while leaving in place a social safety net for those individuals whose capital home-

stead accumulations were insufficient to generate an income to meet their basic needs.

- The Federal Reserve would revive its existing money-creating powers under Section 13 of the Federal Reserve Act, opening its discount window to provide sufficient money and capital credit to finance the estimated $2 trillion needed annually for new plant and equipment, new technology, new rentable space, and new infrastructure. Channeled through each citizen's Capital Homestead Account (CHA), Fed-monetized credit would be allocated by the competitive banking system to financially sound investments and irrigated through mechanisms that systematically create new owners of the new wealth, without taking old wealth from existing owners.
- Five central banking innovations would be introduced: (1) a two-tiered Federal Reserve credit policy that favors broadly owned private sector growth over nonproductive government and consumer borrowing; (2) a shift to the Federal Reserve's discount mechanism from its Open Market Committee for controlling the money supply, thus freeing growth from its current dependency on past savings; (3) 100% reserves (the "Chicago Plan") to replace fractional reserve banking; (4) the Federal Capital Credit Corporation (FCCC),[1] a Fannie-Mae-type "bundling" operation to facilitate Capital Homesteading loans and establish national standards for lenders; and (5) the Federal Capital Insurance Corporation (FCIC),[2] to provide an alternative to traditional forms of collateral, thereby eliminating a major barrier to widespread citizen participation in significant capital ownership.
- Capital Homesteading would offer an economic growth model based on access to private property as a fundamental human right, encouraging other countries to emulate America by lifting themselves into economic prosperity, thus building a more free, just and unified global market, the economic foundation for enduring political democracy and peace around the world.

INTRODUCTION

Social Security is a system built to collapse. While the horrific events of September 11, 2001 wrenched the nation's attention away momentarily from retirement security to national security, the economic costs of this one terrorist assault on America, coupled with an already ailing economy and the "bursting of the bubble" of publicly-traded securities, placed an even greater burden on America's public retirement system, hastening its day of bankruptcy.

Prior to the September 11 attacks, according to the *Washington Post,* congressional estimates projected that the government would drain almost all the Social Security surplus to operate at current levels through 2011, "imperiling the retirements of the baby-boom generation."[3] In the face of massive layoffs and economic displacement caused by the attacks, Congress must now consider in its budget debates the billions needed to cover the replacement of destroyed property, insurance losses, homeland security, rebuilding postwar Iraq and Afghanistan, and other related costs. In the long-term, Federal Reserve Chairman Alan Greenspan warned that the demand for added security will force firms to cut back on employment and productive activities such as research and capital investment.[4]

The bipartisan Presidential Commission on Social Security issued its final report, *Strengthening Social Security and Creating Personal Wealth for All Americans*, on December 11, 2001. The report concluded: "Social Security is in need of an overhaul. The system is not sustainable as currently structured.... (p.7)" While the commission members agreed on the use of Private Savings Accounts (PSAs) to allow Americans to invest in the stock market a portion of their Social Security funds, they were unable to offer a unified set of recommendations. There was no consensus on what percentage of Social Security assets should be put into publicly traded securities. It was also assumed that there was no better way for workers to invest than to place their wages and savings in the stock market (mainly via mutual funds). Even more important, as many commentators observed, the commission failed to recommend any significant structural reforms for maintaining the long-term viability of Social Security.

Flaws in the Foundation

At the inception of the Social Security program in 1936, the United States Government promised explicitly, "What you get from the Government plan will always be more than you have paid in taxes and usually more than you can get for yourself by putting away the same amount of money each week in some other way."[5] Unfortunately and predictably, however, the increase in benefit obligations over time has made the original promise unsupportable, even though today 76 percent of Americans pay more in payroll taxes than they do in federal income taxes.[6]

Most people are living longer than age 65, the life expectancy projected when the Social Security program was born, and they are getting higher benefits than the system had originally expected to pay out. As the population growth rate in the U.S. declines, there will be a shrinking pool of working Americans paying higher taxes to cover Social Security benefits for a growing pool of retirees. As the *Wall Street Journal* summed it up in 1988: "Baby boomers and their children will pay more for their own retirement and get less in return."[7]

Some analysts have warned that, calculated at present value, projected Social Security deficits combined with those of Medicare could reach $43 *trillion*.[8] This dwarfs the projected $3.5 trillion in federal budget deficits that the government officially reports as its current level of public debt. In contrast to credit extended to private enterprises, there are no productive capital assets standing behind public sector debt.

Part of the reason for the present crisis is that shortly after its creation, Social Security abandoned its original purpose as a social safety net/insurance program to ensure every working American a minimally adequate income after retirement. It is now expected to provide the bulk, if not all, of a person's retirement income. If Social Security collapses, many retirees will be left economically vulnerable and dependent on their families, public welfare or charity.

Society's great expectations, and the efforts of policymakers to satisfy them, rest on a shaky edifice erected on a flawed foundation. Three of the most serious structural weaknesses are:

1. Social Security is a pay-as-you-go system and has no productive assets, but rather government debt in the form of government bonds and Treasury bills to stand behind the government's mounting promises. Nobel economist Paul A. Samuelson even proclaimed the system "the greatest Ponzi game ever contrived." [9] The problem with pyramid schemes, however, is that they eventually leave someone "holding the bag." It is anticipated that by 2020, Social Security could begin to pay out more than it collects, forcing the Federal government to reduce benefit levels, tap into general revenues, or print money to meet the deficits.[10]
2. An unhealthy generational political split is inevitable between younger workers and aging Social Security recipients. Potential beneficiaries are growing larger in number. 75 million baby boomers will soon join their ranks. The working population who pay into the system (and whose payrolls are taxed from dollar one) is shrinking in proportion to the recipient population. In 1940, soon after the program was launched, most Americans died before reaching the eligible Social Security age of 65, and the burden ratio was roughly 42 to 1. Now the burden ratio is about 3 to 1, putting the weight of more and more dependents on fewer and fewer backs.[11]
3. The rich are largely exempted from sharing in this mounting burden. Not only is there a cap on salaries taxed for the so-called trust fund,[12] but also there is no tax on incomes from dividends, interest, and capital gains to support Social Security. The payroll tax is extremely regressive, placing the greatest burden on the working poor who must pay into the system from the first dollar of earnings. Thus high-income workers and the wealthiest Americans escape the responsibility to meet the nation's promises to poor and middle-class workers.

Social Security and Enron

Wall Street debacles such as Enron, Global Crossing and WorldCom are certain to have an impact on the Social Security system and its reform. Were these corporate disasters merely aberrations or do they reveal a fundamental flaw in the present system upon which the Bush administration and other policymakers hope to build a privatized retirement system?

Analysts such as Daniel Yergin have characterized Enron's collapse as the inevitable outcome of a system driven by the "quarterly stampede" of investors to companies whose quarterly performance is able to meet the "consensus forecast" of stock analysts:

> The name of the game was to keep those earnings coming. Not because they meant dividends, which went out of fashion. The whole system depended on rising stock prices. Who was calling the shots? To a considerable degree, it was all of us — and our $11.5 trillion fortune of retirement savings. The quest for 'shareholder' value and higher returns was the guarantee that our retirements would be okay, and we expected our money managers to deliver. Their compensation and even jobs depended on their performance.[13]

Companies that do not show a quarterly rise in stock prices and earnings risk being dumped by pension fund managers who have invested huge sums of retirement funds in them. Such outflows of investment dollars drive a company's share price even lower, making it a prime target for such "serial acquirers" as WorldCom.

Further motivating company executives to show increased quarterly earnings is the shift in the bulk of executive compensation from fixed salaries to option packages. Stock options (frequently misidentified as ESOPs, which are employee stock *ownership* plans) were hailed as a way of aligning the interests of management with those of shareholders. Yergin points out, however, that options became an attractive means for executives to "have their cake and eat it," at the expense of shareholders:

> Unlike shareholders, executives suffered no out-of-pocket penalty if the share price went down. Moreover, the options, which could

eventually be worth tens or even hundreds of millions of dollars, were not charged as an expense, masking their real cost to shareholders.[14]

Share prices can also be manipulated, as Enron and WorldCom proved, through improper accounting practices. In those cases, accounting firms serving the companies' board of directors as both auditors *and* consultants (which should have been seen by regulators as a conflict of interest), had an incentive to hide information from shareholders through questionable adjustments to financial reports.

Are Enron, Global Crossing and WorldCom reflections of a financial system that is inherently prone to the sorts of speculative bubbles and "irrational exuberance" of which Federal Reserve Chairman Alan Greenspan spoke in December 1996 when the Dow was at 6,437?[15] Does today's financial system of trading in secondary issuances even constitute real investment, or is just another form of gambling? Should the retirement security of Americans be governed by the "Greater Fool Theory,"[16] or should we seek to connect systematically more citizens as owners to real growth in the economy?

As a result of Enron there has been a further deterioration of pubic confidence in corporate governance and credibility, and the institutions that are meant to oversee them. How long the public's "malaise" will continue before the stock market is "pumped up" by the next temporary stimulus (such as tax cuts or higher defense spending for the war on terrorism), is anyone's guess.

What is clear is that our institutions, and the values and systems that govern their operation, will have a profound influence on the culture and value systems of our society as a whole. For companies driven by Wall Street's incessant demands for higher share values, delivering quality and value to customers has given way to hype and buzz as the business strategy of choice. The property rights of small investors are virtually non-existent. Executives and boards of directors are largely non-accountable and company financials, non-transparent. Workers are viewed as assets, or even worse, as commodities to be dumped if necessary to boost corporate "productivity" measurements.

Social Security and the Wealth Gap

The inherent weakness of the present Social Security system and a possible solution to its ills, become even more clear when viewed against the backdrop of another dangerous social phenomenon: the growing "wealth gap." While a few commentators like P.J. O'Rourke might argue that the widening economic differential between rich and poor is an unavoidable or even a healthy consequence of our "free market system,"[17] growing evidence challenges that position. [*See* Appendix 5.]

Contrary to President Kennedy's dictum that "a rising tide lifts all boats," not only are all "boats" *not* rising together, a great many are sinking — while a few others have lifted into the stratosphere.[18] As political thinkers from George Mason to Abraham Lincoln to Ronald Reagan recognized, America's political democracy requires an economic counterpart to sustain it. Furthermore, gross disparities in wealth and economic power merely fuel world-wide resentment against America and globalization of the marketplace. As September 11th reminds us, America is not an island unto itself.

Addressing the Social Security Problem from a Systems Perspective

The proposals contained in this report focus primarily on addressing one problem in our economic infrastructure — the impending collapse of our Social Security system. Other problems that will affect the future of our nation's retirement income system include:

- A looming crisis in the health system
- So-called "overcapacity" in the economy
- Displacement of jobs by advancing technologies
- A growing wealth and income gap
- Enormous and rising consumer and government debt
- Huge budget deficits in our largest cities and states
- Loss of basic industries
- The continuing U.S. trade deficit
- Wage arbitrage and flight of jobs to lower wage countries

The problem with piecemeal solutions is that they often breed problems of their own. What policymakers have yet to consider is a comprehensive economic strategy for (1) stimulating sustainable, non-inflationary private sector growth and (2) connecting more and more people to the ownership of that growth. Such a strategy would offer the opportunity and access to the means for every American citizen, particularly the poorest of the poor, to acquire, share the rights and status of first-class shareholders, and enjoy the fruits of productive equity.

This long-range agenda would involve major restructuring of our laws and economic policies to foster more equitable distribution of future corporate capital, more robust rates of private sector investment, and a shift in the source of mass purchasing power from inflationary increases in wages and welfare payments to increased profit sharing and dividend incomes.

Our top business schools continue to preach Wall Street capitalism as the model for America and the world. Yet we ask, can a system that promotes short-term thinking and gambling, and encourages greed, cheating, and non-accountability, produce an ethical, justice-based business environment necessary in the long-run for sustainable economic development?

Contrary to the claims of its most ardent advocates, the Wall Street model, through defective financial, tax, and legal institutions, has helped create barriers to a truly free and just market economy. We see instead gross concentrations of money and power, with fewer and fewer competitors. Wall Street capitalism has fostered a 21st Century brand of mercantilism (the very thing Adam Smith abhorred), where businesses buy political favors to insulate themselves from competition. Today's elitist and exclusionary economic system contradicts and undermines America's populist values and democratic institutions.

In the not-too-distant future, when most of the Baby Boom generation have entered their retirement years, the very foundations of America's economy will be tested. Our policy decisions today will shape the quality of life enjoyed, or suffered, by those retirees, as well as by the rest of society.

At some point, even the most financially secure, starry-eyed optimist will face the inevitable questions: Can Social Security really deliver on its promises? Can our present economic system generate sufficient rates of growth and broad-based prosperity to meet those promises? Will the system bring social harmony, or will it lead to class warfare and generational strife?

What we need for the long-term is an economic system based both on sound moral and sound market principles. What we need *now* is a plan for sustainable growth in which every citizen from birth can gain a viable ownership stake in the new capital frontier.

I. THE PROPOSAL IN BRIEF

How do we fix Social Security before it collapses? A comprehensive national strategy called “Capital Homesteading” would address this challenge through a radically new policy thrust — the *democratization of capital credit*. As will be presented in this book, the critical reform needed to democratize capital credit involves reactivating Section 13 of the Federal Reserve Act of 1913.

Specifically, this book proposes that the rarely employed “discount window” of the Federal Reserve be “reopened,” with appropriate modifications and safeguards, to allow qualified banks and financial institutions to discount “eligible” industrial, commercial, and agricultural paper representing loans for productive purposes. Qualified lenders could then provide low-cost capital credit to businesses and farms through mechanisms that systematically broaden capital ownership of new private sector growth among workers and farmers, area residents, and citizens generally who own little or no productive assets.

Expanding the role of the Federal Reserve’s discount window in national monetary policy is a proposition that policymakers are beginning to give serious consideration. As part of its strategy to manage interest rates more effectively, the Federal Reserve recently began overhauling its procedures for making loans to commercial banks via its discount mechanism.[19]

Big problems require big solutions. We realize that the scope of our proposal may appear grandiose to some. However, we believe that the crisis facing Social Security requires comprehensive “systems” re-engineering. Rethinking the fundamentals of a system often requires new terminology, or specifically nuanced usages of traditional terms. For the reader’s convenience and for clarity of argumentation, we have included a glossary defining our terms.

Before examining each of the basic components of a national Capital Homesteading strategy in detail, we will briefly outline the proposal as it can be applied to address the fundamental problems underlying the Social Security System.

A Capital Homesteading Solution For Social Security

First, under the proposed Capital Homesteading reforms, *Congress would keep all benefit promises previously made to citizens under the Social Security and Medicare programs.* As will be described in greater detail below, Capital Homesteading reforms would increase the sources of taxes to cover the benefit promises.

The overall strategy would also offer an asset-backed supplement for retirement incomes not dependent on redistributive taxation or the somewhat speculative results of publicly traded securities. It would stabilize at present levels any future commitments under Social Security and Medicare. This would tend to "flatten out" the rate of increases in benefit levels, while increasing funding for current promises.

Second, to meet Social Security and Medicare commitments, *revenue sources would be shifted from the regressive 12.4% payroll tax (a combined tax paid by employers and employees on all wages below $87,000[20]) to general tax revenues paid from all sources of consumption income over a poverty level.* (This would eliminate one of the most harmful taxes imposed on the working poor. At the same time it would radically reduce production costs of American industry, improving America's competitive position in world trade.)

Incomes below $10,000 for each adult and $5,000 per child would be exempt from any taxes. Property incomes from dividends, rent, interest, and inflation-indexed capital gains would be fully taxed at the same rate as wage and salary incomes. Those above the poverty level would pay taxes at a single rate on all income above the exemptions, from whatever source their income was derived. The single tax rate would be calculated to balance the budget and retire the national debt over 20 to 30 years.

Under Capital Homesteading *all* income of individuals, not just wages and salaries, would be considered "earned." Thus, property incomes would be included in the definition of "earned income," and the income cap (currently at $87,000 of wage income) would be removed on earned income subject to supporting Social Security and Medicare benefits. *This* *change alone would help increase revenues to prevent bankruptcy of the social security system.*

Dividends on Capital Homesteading shares would be tax-deductible to the corporation, encouraging higher dividend payouts (which as mentioned above, would increase individuals' taxable incomes). This would give corporations a socially beneficial way to escape double and triple taxation on corporate profits, and would induce new share issuances for financing new capital assets.

Third, the Federal Reserve System would employ its discount powers under Section 13 of the Federal Reserve Act of 1913 [*see* Appendix 2, "Extract from Section 13 of the Federal Reserve Act of 1913"] so that member banks could make lower-cost, asset-backed, "non-recourse" Capital Homestead (CH) loans to enable every US citizen to invest in newly issued, full dividend payout, full voting shares voluntarily issued by "eligible" private sector corporations. Such shares would finance a growing portion of the nation's annual growth needs for new technologies, new plant and equipment, new rentable space and new infrastructure.

Democratized capital credit would also free economic growth from both government subsidies and the "slavery of past savings." It would offer all Americans a means of accumulating individual capital estates through "future savings" of the earnings from their own capital assets. [*See* Appendix 4, "A New Look at Prices and Money: The Kelsonian Binary Model for Achieving Rapid Growth Without Inflation."]

Re-Envisioning the Future of Social Security

According to the January 2001 *Economic Report of the President,* a growth increment of about $2 trillion dollars of new productive assets was added to the U.S. "capital tree" in the year 2001[21] — or about $6,755 for every man, woman and child in America. Let's see what would happen if the Federal Reserve System "monetized" a portion of that growth through privately insured Capital Homestead (CH) loans backed dollar-for-dollar by the newly formed productive assets.

Assume that every year each citizen could borrow $3,000 from local banks and financial institutions to invest in private sector shares representing about one-half of the real productive growth of the economy at present capital growth rates.[22] Under this national strategy, a child born today could retire at age 65 with a tax-sheltered Capital Homestead

(CH) stake of about $200,000, yielding a yearly "second income" of $30,000. Furthermore, over that period he would have received dividends totaling over $750,000. [*See* Appendix 3, "What Capital Homesteading Would Mean to the Average American: Projected Wealth and Income Accumulations Under Capital Homesteading."]

This scenario assumes (1) no increase in America's capital growth rate, (2) $3,000 for purchasing the newly issued CH "growth" shares, borrowed annually from local banks at an unsubsidized "pure credit" borrowing rate (interest-free with a service charge to cover administrative costs, risk and capital insurance premiums, and normal bank profit margins), (3) no increase in share values, and (4) a 15% annual pre-tax, pre-dividend return on investment[23] as the sole source for repaying the stock purchase loans.

When the dividend returns from this almost trillion dollar capital "growth pie" are spread among all citizens, consumer buying power would increase, fueling higher rates of investment. As consumption incomes expanded, growth rates could increase to the full productive capacity of the economy. This would lift the American economy from the inherently inflationary and feudalistic "wage system" to a more inclusive and more participative market economy, with much less pressure for redistributive taxation.

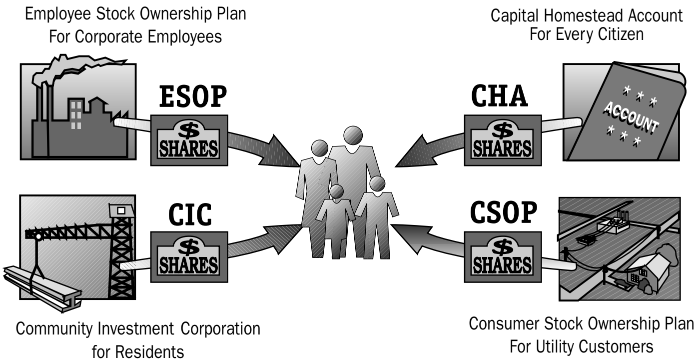
How Would Capital Homesteading Work?

The preferred method for democratizing access to CH loans is to allocate to each citizen and every member of his family an equal amount of CH loans periodically (*e.g.*, quarterly) based on periodic estimates of the total capital credit needed by private enterprises (*i.e.,* capital demand).[24] The citizen would then go to his or her local bank, where the citizen would receive investment advice. The bank would set up a "Capital Homestead Account" (a "CHA," similar to an IRA, but with differences noted below). The CHA would receive on the citizen's behalf periodic loans from the bank for the purchase of "eligible" full voting, full dividend-payout shares issued by "qualified" private sector enterprises in need of capital for expansion, modernization or for purchasing outstanding shares from present shareowners.

The citizen would have the choice to invest his allotment of credit among shares of (1) the company for which a member of the family works, (2) a company, like a utility, mass transit system, or comprehensive health care delivery system, in which he is a regular customer with a regular billing account, (3) a for-profit Community Investment Corporation for developing land and infrastructure in his local community or region, or (4) a diversified blend of mature companies with proven records of profitability and sound management.

Capital Homesteading

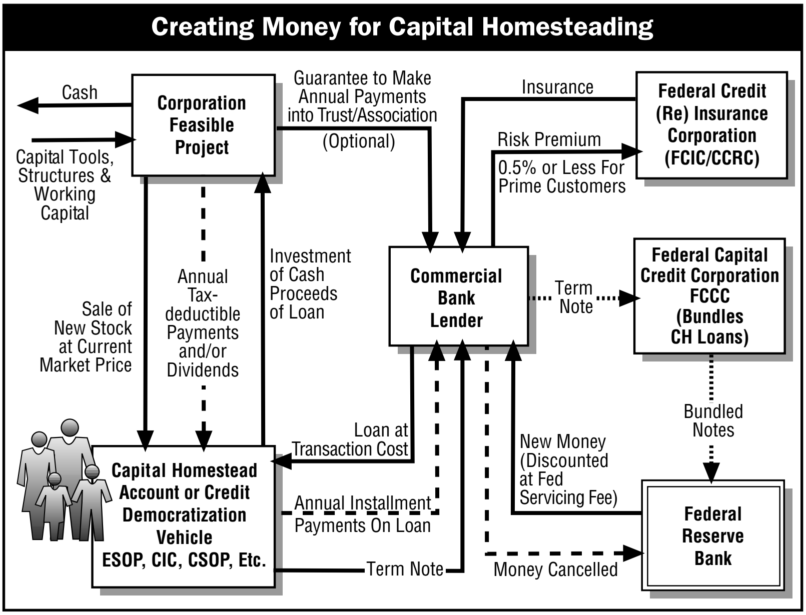
Through access to low-cost capital credit, citizens would build up their capital accumulations through such vehicles as CHAs, ESOPs, CSOPs, and CICs, as well as through inheritance, gifts, savings, etc.



Before taking the loan paper to the discount window of the regional Federal Reserve Bank for monetizing at a Fed service charge of 0.5%, the local bank would have the option of self-insuring the loan or insuring against loan default with a commercial insurer of CH loan paper. Loan default reinsurance, preferably offered by the private sector, would further spread the risk of default. Debt service, including risk premium charges, on each loan received by the citizen's CHA would be repaid from future pre-tax dividend distributions paid by each of the companies that issue the CH shares.

To further support Capital Homesteading, a Federal Capital Credit Corporation (FCCC) could be set up, similar to the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Mortgage Corporation ("Freddie Mac"), to package and set national standards for insured, self-liquidating capital loans and then discount these loans at the discount window of one of the 12 regional Federal Reserve banks. The Federal Reserve would treat insured CH loan paper as backing for the U.S. currency, substituting for today's government debt paper.[25]

The following diagram illustrates the interrelationships between the different elements of the system and how money and credit can be created to bring about non-inflationary private sector growth linked to expanded capital ownership:



The projected annual yield from the proposed Capital Homestead program requires no reduction in take-home pay, savings, or consumption incomes to purchase "eligible" shares from "qualified" companies. No taxpayer subsidies would be required. All borrowings could be insured privately against the risk that an issuing company would not generate dividends to service the share acquisition loans. The "risk premium" included within each individual loan would generate the revenues to sustain the insurance pool.

Such insurance, structured like home mortgage insurance, represents a private sector solution for overcoming the collateralization barrier for the poor and middle-income borrowers who have no assets to pledge and who would otherwise have no access to capital credit on the same basis as the wealthiest 5% of Americans.

Insuring Minimum Social Security and Medicare Benefits

There is always the risk that some Capital Homestead Accounts will not generate enough capital incomes, after the shares are paid for, to meet the minimum benefit levels guaranteed under the Social Security and Medicare programs. Some of the investments will fail. Some capital homesteaders may squander their accumulations and have to start over again.

One way to address these risks is to establish what Milton Friedman once proposed as a "Negative Income Tax." An even better way is to establish a minimum income guarantee fund, supported by either general revenues or premiums charged each citizen having a CHA, or a combination of both. These funds could be used to purchase a blend of stock and bond index funds sufficient to cover guaranteed minimum Social Security and Medicare benefits in the event the yields from one's Capital Homestead Account drop below these minimum levels.

Capital Homestead Accounts (CHAs) vs. Personal Savings Accounts (PSAs)

While there remains significant opposition by many Americans, support is growing for shifting at least a portion of Social Security to private investments by individuals, or allowing such personal investment as an "add-on" to Social Security income. An August 2002 Washington Post-Kaiser Family Foundation-Harvard poll indicated that 61 percent of young voters (30 and younger) favor individual investment accounts in Social Security, while 67 percent of the elderly are opposed.[26]

The Bush Administration has proposed the use of Private Savings Accounts (PSAs). Previously, a 1996 report by the Cato Institute's Project on Social Security Privatization recommended the use of PSAs in privatizing social security, characterizing such an approach as "A Big Boost for the Poor."[27] Michael Tanner, the director of the project and the report's author, asserted that in such a privatized system,

> [A]n individual's benefits would not be dependent on life expectancy [usually lower among the poor]. Individuals would have a property right in their benefits. Any benefits remaining at their deaths would become part of their estates, inherited by their heirs.... Privatization would increase national savings and provide a new pool of capital for investment that would be particularly beneficial to the poor."[28]

Functioning as a "mandatory savings plan," a privatized social security program would deposit into the PSA the portion of the payroll tax that comprises the employer and employee contributions to the Old-Age and Survivors Insurance (OASI) portion of the Social Security tax.

The PSA would operate like the current IRA, where individuals would be penalized for withdrawing funds before their retirement. PSAs would be managed by the private investment industry. Individuals could choose their own fund manager and change them whenever they wished. The government would establish regulations on portfolio risk to prevent speculation and protect consumers. In addition, the government could continue to provide a minimum safety net, through either a guaranteed minimum benefit or a floor benefit.

Citing Chile's success with its privatized pension system, Tanner highlighted another benefit of the proposed PSA approach:

> [I]t would give every American — including poor Americans — an opportunity to participate in the economy by owning it…. Through Social Security privatization, workers would become stockholders. The division between labor and capital would be broken down.[29]

For all its advantages over the present Social Security system, however, there are certain inherent problems with the Personal Savings Account approach.

First, PSAs as currently proposed are only meaningful to a person who (1) is employed and (2) has sufficient discretionary income to invest. Proposals to contribute welfare-type payments into PSAs or Individual Development Accounts (IDAs) of the poor (or as some have suggested, to every child upon birth[30]), are dependent on taxpayer dollars and thus remain politically vulnerable.

Second, the PSA approach is tied to Wall Street and the money managers and investment brokers who earn their living from a system that is based on speculation in secondary issuances, not real investment and growth. Rather than empowering workers and small investors, the financial system underlying such corporate debacles as Enron and WorldCom made it easy for corporate leaders and big accounting firms to dupe even the Wall Street gurus, and to betray investors and employee-shareholders. Does it make sense to entrust our retirement incomes to a top-down, non-accountable, power-concentrating system that undermines the property rights of individual shareholders?

Capital Homestead Accounts (CHAs) would overcome many of the weaknesses of the PSA/IDA proposals. Rather than requiring that people reduce their current consumption levels and personal savings, CHAs would provide access to nonrecourse, self-liquidating capital credit to every citizen from birth. In this way, every citizen could accumulate a growing tax-deferred capital accumulation, in the most equitable and direct fashion, from the bottom-up, and without depending on the taxpayer or the past savings of others.

Under the CHA approach, individuals could receive over the course of their lifetimes dividend incomes generated by their capital accumulations, once the loan for a particular capital acquisition has been repaid. (While the capital assets would accumulate tax-free up to a proposed $750,000 "Capital Homestead exemption" level, income taken out of the account for consumption purposes would be taxed at a regular income tax rate.) Thus the incomes generated by CHA holdings would be available to recipients much sooner, creating more effective consumer demand in the economy as well as demand for capital investment.

The CHA approach would put power and trust in individual Americans and their local bankers (who would have a long-term investor's interest in the feasibility of a capital project), rather than handing more dollars and power to Wall Street stockbrokers and asset speculators pushing the latest "hot stock."

Genuine Social Security: Sharing in a Growing Economy

It should be noted that the Capital Homesteading alternative for financing America's future investment assets would produce higher annual retirement incomes (conservatively estimated at $30,000) than most Social Security retirees receive today. Plus, as mentioned earlier, a person's Homesteading assets would have produced for him or her, *prior* to retirement, dividends totaling over $750,000.

Eventually, participation in the Social Security system (as a minimum income guarantee program) could be based entirely on need. This would protect those who have anticipated Social Security and Medicare benefits upon reaching retirement age, while reducing the burden on the system by not paying benefits to those who do not need them. Merging FICA and other payroll taxes into a single rate general tax system would both prevent the future bankruptcy of the system and dispel the myth that Social Security was ever intended as anything other than a redistributive, pay-as-you-go welfare system.

If properly implemented within economically feasible ventures, there would be no harmful inflationary effects to the economy. Future prices of U.S. goods and services would be more price competitive in global markets because the new equity entitlements offered to workers under Capital Homesteading would raise their incomes and accumulations without raising fixed labor costs. Rising consumption incomes would be tied directly to the rising productiveness of capital, linking people directly as owners to technological progress. In fact, these reforms would stabilize the value of the U.S. dollar since there would be real productive assets backing the U.S. currency, rather than nonproductive government debt paper as is the case today.

CAPITAL HOMESTEADING
For Every Citizen

"[A] superb study of social security reform. If the plan were to be converted into public policy it would not only cure the social security crisis it would transform the United States economically and socially, turning a nation of employees into a nation of owners of productive capital."

> Dr. Norman A. Bailey, Senior Fellow, the Potomac Foundation and former Special Assistant to President Ronald Reagan for International Economic Affairs

"The idea is a vast one, but it recommends itself as a strong private sector alternative to retirement under Social Security, which is not going to survive. It expands the principle of capital ownership and thereby fortifies the U.S. middle class."

> Curtin Winsor, Jr., former U.S. Ambassador to Costa Rica and Board Member of the William H. Donner Foundation

"This report is a seminal contribution to any serious discussion of freedom, opportunity and responsibility in the United States and the world. Building upon the concept of binary economics as first advanced by Louis Kelso, this report could serve as the basis of a much-needed debate, carrying us beyond the arbitrary restrictions of current intellectual habits."

> Richard W. Boone, Director of Project for Participatory Democracy of the Tides Center and former Executive Director of the Citizens Crusade Against Poverty

"A provocative perspective on a fast-emerging financial challenge that policy-makers in both major parties refuse to address: the retirement needs of the nation's largest-ever retiree generation, the Baby Boomers."

> Jeff Gates, author of *The Ownership Solution* and President of Shared Capitalism Institute

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