Against privatization: The genius of Social Security

by Donn Mitchell in the Sep 23, 1998 issue

Frances Perkins knew how difficult life could be. As a settlement-house worker in Chicago, a church worker in Philadelphia and a factory investigator in New York City, she had learned why social legislation was needed and what it took to get it passed.

When Perkins became secretary of labor in 1933, unemployment approached 30 percent. Facing the most demanding job of her life, she made arrangements for regular rest and replenishment--as she believed all people should be permitted and encouraged to do. On the advice of her pastor, Perkins spent one day a month in silent retreat at the Maryland convent of All Saints Sisters of the Poor, one of the oldest religious orders in the Episcopal Church. She continued the practice throughout her 12 years in Franklin D. Roosevelt's cabinet, where she was the principal advocate and lead architect of the Social Security Act, designed to make a secure retirement possible for nearly all Americans.

An adult convert to Anglicanism, Perkins was steeped in the *Lux Mundi* theology of Bishop Charles Gore and a subsequent generation of British Anglo-Catholic socialists, such as Conrad Noel, Maurice Reckitt, W. G. Peck and William Temple. She had met many of them personally through the Summer School of Christian Sociology. Perkins and her British counterparts espoused a sacramental sociology that considered not only the ecclesia but the broader community as a gift from God--an outward and visible sign through which grace is given tangible expression.

Perkins thought of insurance as a brilliant marriage of religion and science. It was a way to realize the moral ideal of neighbor helping neighbor through actuarial science. In practical terms, insurance translated mercy into money, compassion into financial assistance. The abstract became concrete, just as the Word had been made flesh.

Although the Social Security Act of 1935 did not include health insurance as Perkins had hoped, it was nonetheless her crowning achievement. Social Security issued its first pension checks the following year and, in three generations, has never missed a payment. Today, with the addition of inflation indexing and Medicare, it keeps 15 million people above the poverty line and millions more out of near poverty. Its administrative costs are less than one cent of every dollar paid in.

Despite this impressive record, 55 percent of the working public surveyed in 1995 said they were not confident Social Security funds would be there for them when they retired. This lack of confidence can be partly explained by our Vietnam-Watergate legacy of political cynicism, aggravated by two decades in which candidates have campaigned against the government as if it were the opposition party. A more serious concern is that the baby-boom generation will be depending on smaller, subsequent generations to finance its retirement benefits.

Daniel Patrick Moynihan, chairman of the Senate Finance Committee's subcommittee on Social Security, insists this fear is groundless. In a communiqué to his New York constituents, he noted that Perkins herself had pointed out as early as 1946 that the system would require actuarial adjustments somewhere around 1980 to keep it solvent into the next century. Those adjustments were made in 1983, and the system is currently running a handsome surplus, with 150 percent of the next year's payout already in hand. This surplus means that the retirement system is no longer pay-as-you-go, with the current generation of workers financing the benefits of the retirees. It is now a partially funded system--that is, some money is already being set aside for the retirement of people who are now working.

Currently, the system can pay full benefits until 2032 and 75 percent thereafter. A tax increase of 2.2 percent, evenly split between employers and employees, would keep benefits at 100 percent indefinitely. In practical terms, people earning $50,000 a year would pay an extra $10 a week for a retirement annuity that is fully protected against inflation and that supports their retired parents at the same time. Those earning less would pay less. The private sector does not provide (at any price) annuities indexed to inflation, nor does it provide retirement vehicles that provide income for parents while the wage earners build their own retirement credits.

Radical structural change is necessary only if Congress insists on converting Social Security to a fully funded plan. There is really no pressing need to do so. Neither education nor defense is fully funded in advance. Neither diplomacy nor the administration of justice nor any other function of government is "endowed." It is simply understood that the government will have to assess its spending needs annually and raise revenues through taxes, fees and bonds.

From both a moral and a social standpoint, there is nothing wrong with current wage earners financing the retirement of their parents' generation. The arrangement is problematic only if one believes that people should never get anything they did not personally earn--as if we all showed up ready for work at birth and paid our own way throughout life. Perkins believed that most of what we get in life is a gift. What we earn through our labors is small change compared to the miracle of our birth, the nurture of our families and other caring adults, and the grace of God. In her view, social arrangements which imitate this primal truth are marks of a godly society.

Despite the success of the Social Security system, the Clinton administration's Advisory Council on Social Security has proposed "reforming" Social Security by entrusting 40 percent of Social Security monies to the stock market. Three reform plans have been proposed, each of which includes prohibitions on attaching moral, social or political conditions to the investments--a direct slap at the churches as well as a grudging acknowledgment of their success in broadening the scope of decision-making in big business through shareholder activism.

The stated rationale for privatization is that the stock market, over time, will offer a higher yield than U.S. Treasury securities, enabling the system to generate more money for retirees without raising taxes. This concept assumes that handsome profits will be made by selling appreciated stocks to other buyers. But there is absolutely no guarantee that the stock market can actually deliver the desired result. If it fails to do so, either an increase in the Social Security tax or a bailout from general tax revenues will still be necessary.

Although the specific proposals put before Congress will vary, the various privatization schemes are likely to be modeled on the three approaches studied by the Advisory Council. The churches should oppose all such schemes, both on moral grounds and in defense of their own mission capabilities. In order to understand why, it is necessary to consider the proposals in some detail.

Two of the three proposals would desocialize the system. They would eliminate its moral centerpiece--shared risk and shared benefit. Individual accounts would be created and benefits would be based on how well individual stock portfolios performed. The system would be transformed from "social security" to mandatory individual risk-taking. This change would create new categories of winners and losers and would offer a bonanza to the brokerage industry, which would collect fees on the trading of upwards of 100 million new portfolios.

A third proposal would preserve the element of social cooperation but, like the other two, would force workers to invest in business corporations while denying them the rights of ownership enjoyed by all other shareholders--rights such as proposing or voting on shareholder resolutions, electing boards of directors and approving mergers.

The importance of these voting rights should not be underestimated. The Advisory Council report acknowledged that, with an estimated $1 trillion to invest, Social Security would own more than 5 percent of every publicly traded corporation in the U.S. Even if the system were a nonvoting investor, its participation would shift control from 51 percent majorities to 46 percent pluralities in every company it held.

Beyond its impact on the governance of major corporations, any privatization scheme would have negative implications for the distribution of wealth and the democratic governance of society, with global ramifications. Amid the lure of financial gain, which is sure to dominate the public debate, the significance of these larger implications is likely to be lost, since few people have a good grasp of the social and democratic characteristics of the existing arrangement.

Since its inception Social Security has been required by law to invest only in bonds or other debt instruments issued by the U.S. Treasury--the next best thing to cash. (If treasury obligations become worthless, so does the paper currency.) Although the sale of these bonds provides immediate cash to the federal treasury, it does not constitute a budget surplus, as the Clinton administration has deceptively implied. It is borrowed money that must be repaid with interest on dates specified at the time of sale. It is like a home-equity line of credit--with one important difference. When homeowners repay their loans, the interest portion of their payments leaves their households forever. The financial institution never returns their interest payments.

But Social Security does return our interest payments to us. Since nearly all taxpayers are in the system, the tax dollars used to pay interest on bonds that the system has purchased are ultimately returned to the taxpayers when they begin collecting retirement benefits. In this way, the profit made by financing the community's needs is broadly distributed to the public rather than concentrated among the owners of banks and other financial institutions. The deferred wages of the working public are lent to the community to finance public needs. The community, in turn, compensates those working by adding interest payments to their deferred wages. The net effect is a financial "ecology" in which a resource is used for a time, then cycled back to its source.

It is not difficult to see why Perkins loved Social Security. It was an institutional embodiment of her vision of what community life is supposed to be--everyone cooperating to improve everyone's life.

The broad public benefits of the system also bolster democracy. All governments, like businesses, need to borrow even when they are not piling up long-term debt. Emergency disaster relief or just meeting the payroll may require cash outlays long before budgeted revenues are actually received. When the federal government needs to borrow, it has a ready lender in the Social Security system. Since the government's borrowing needs are determined by Congress, the public ultimately has a form of political control over how its deferred wages are invested. If the government borrows money to build bombs rather than schools, citizens can band together to change those priorities.

However, by investing 40 percent of the Social Security fund in stocks, all three of the privatization schemes would greatly reduce the size of this public lender. The government would be forced to rely increasingly on private capital markets for its borrowing needs. Unelected financiers would gain power over the federal government, power they now hold over city and state governments. By threatening to downgrade the federal government's bond ratings, they would be able to dictate federal tax policy and the size of the federal payroll.

A second negative implication is that, because of globalization, an ever-greater portion of the national debt would be held by nondomestic financial interests. While there is nothing wrong per se with foreign involvement in our economy, there is a clear advantage to arrangements in which creditor and debtor have a stake in each other's well-being. As Abraham Lincoln said, "The great advantage of citizens being creditors as well as debtors, with relation to the public debt, is obvious. Men can readily perceive that they cannot be much oppressed by a debt which they owe to themselves."

Power over tax and spending decisions would shift from a Congress and president accountable to the electorate as a whole to private financial interests. The franchise would convert from "one person, one vote" to "one dollar, one vote," without the time and expense (or public scrutiny) of a constitutional amendment. The net effect would be a monetarized version of the original constitutional requirement that voters be property holders. The implications for economic policy are clear: we would remain a low-wage, low-tax, low-social-benefit economy with little hope of change through democratic means.

The effects of the Social Security change would be felt worldwide. The revenue-negative policies of the federal government since the beginning of the Reagan administration have already exerted a downward pull on the high-wage, high-tax, high-social-benefit economies of Canada and the nations in the European Union. All have had to respond by lowering their own tax rates in order to prevent capital flight to the U.S. Any intensification of this trend will refeudalize the developed world by transferring sovereignty from popularly governed nation-states to global corporations whose authority comes from massive wealth and irresistible power rather than from the consent of the governed.

Increased federal reliance on private capital markets also raises some purely financial concerns. Competition between a borrower as large as the federal government and other private sector borrowers for loan monies drives up interest rates. Simultaneously, stock prices begin to fall as investors sell their stock and invest the money in bonds and other debt instruments to take advantage of the high returns.

If this scenario were to occur, the goal of financing Social Security benefits with profits from the sale of appreciated stock would prove to be elusive. Social Security would have to sell massive amounts of stock to finance baby-boom retirement at precisely the time when the market was flooded with stock. Sellers would include not only investors prompted by high interest rates to switch to debt instruments, but private pension plans seeking to finance their baby-boom obligations, and the boomers themselves, seeking to liquidate assets to supplement pension income.

Many enthusiasts of privatization dismiss the interest-rate impact because they believe that the federal government will become smaller and thus have lower borrowing needs. But this is a naïve hope in a country whose population continues to grow. (The population is double what it was when the Social Security Act was passed.) Others will argue that higher interest rates will not depress stock prices because the presence of a mandatory purchaser the size of Social Security will keep stock prices high. Even if these enthusiasts turn out to be right about the financial aspects of privatization, its negative implications for democracy should prompt the churches to demand that nonprivatization alternatives, such as raising the amount of income on which the tax is paid, be considered. The Advisory Council did not consider such plans.

Another area in need of study is the impact of a national policy of full employment at higher wages. Such a policy would increase the revenue flows into Social Security and all other levels of government without raising taxes. It would also reduce the strain on human services providers by reducing demand. It might also reduce the influence of business corporations on nonprofit organizations by broadening the base of individuals who have sufficient discretionary income to make voluntary contributions.

Higher wages would enable more Americans to take advantage of existing stock-based private-sector retirement plans, such as IRAs, 401Ks, insurance annuities and mutual funds. Those lucky enough to be covered by employer-sponsored pension funds would also benefit because their employers would be making proportionately larger contributions to the fund on their behalf. In other words, people who believe in the market would be freer to act on their faith, taking whatever risks they want without exposing everybody else to them. Social Security would remain true to its original intent.

For Perkins, of course, Social Security was never about strategic investment or shrewd calculation. It was about relationship, the community's commitment to its individual members. The intent was never to beat Mammon at its own game, but to create conditions in which charity could prevail.