

Prospects for Social Security Reform

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Frontispiece: Special Treasury securities, stored in a federal government filing cabinet in West Virginia, represent \$700 billion in Social Security Trust Fund assets. Photo: Jeff Baughan.

Chapter 15

An Organized Labor Perspective on Social Security Reform

David S. Blitzstein

Organized labor has participated in the Advisory Council on Social Security process from the very beginning. The famous 1937–38 Council which designed the U.S. social security system included Sidney Hillman of the Amalgamated Clothing Workers and Philip Murray of the United Mine Workers. Organized labor has had representation on all of the Advisory Councils over the years, a requirement put into the law in 1956. On this last round, three representatives of organized labor were members of the 1994–96 Advisory Council.

These three labor members of the 1994–96 Advisory Council, along with three other Council members, supported the Maintain Benefits (MB) proposal. Labor members of the Council were in agreement with organized labor's support of social security's long-term guiding principles. These are to ensure a system that provides universal coverage with benefits that are an earned right and benefits that are wage-related. Also, we believe social security should remain a system based on compulsory contributions, and one that is self-financed. Finally, we maintain that social security should be a system that is redistributive for purposes of setting adequate benefits, a system that is not means-tested, a system that is portable and wage-indexed, and one that provides inflation-protected benefits. Organized labor has been a strong advocate of social security since its inception, and has actively promoted its expansion of coverage and benefits from 1935 to the present.

Over the years, organized labor has leveraged its support for social security by developing a strategy to promote private pensions through collective bargaining. Led by the success of the United Mine Workers and the United Auto Workers in the late 1940s, unions began to negotiate pension pre-funded defined benefit (DB) pension plans. The auto workers, in a brilliantly orchestrated campaign called "Too old to work, too young to die," deliberately integrated their pension proposals with social security

benefits in an effort to encourage employers to support expanded social security benefits. In the early days, the combined negotiated benefit of \$100 a month was a fixed amount, so any increase in social security reduced the company's financial obligation. As social security benefits increased over time, unions tended to drop these integration provisions (Fraser 1990). However, social security benefits are still a major factor in determining union bargaining policy as it relates to negotiating adequate retirement benefits.

Despite organized labor's council members' support for the MB plan, it is important to state that this proposal of the Advisory Council does not represent the AFL-CIO's official position on social security. This is because the AFL-CIO's governing executive council is in the process of updating and refining its stance on social security policy. For this reason, my objective is to critique some of the social security privatization proposals and to discuss the role of social security from a national perspective. This discussion is based on my experience representing organized labor as a pension negotiator and acting as a trustee of several multiemployer pension funds.

The Emergence of the Privatizers

The last Advisory Council marks a political watershed. Its report is the first by an Advisory Council in 60 years that failed to support unanimously the social insurance principles of the system's founding fathers. This is also the first council report in which a group of members formally recommended a partial privatization of the social security system. Even the 1982–83 National Commission on Social Security Reform, a group convening during the height of the Reagan era, rejected privatization in the face of a system financial crisis of an immediate nature (rather than a future one, such as we face now).

What is interesting about the current debate is its timing. It is surprising that privatization has gained a national audience now, just as the social security system is in the process of building historically large surpluses to pay for the baby boom generation's retirement.

The roots of this movement may be traced to the 1983 amendments. As Paul Starr noted a decade ago, pay-as-you-go (PAYGO) financing was the bane of privatization because it was nearly impossible to undo (Starr 1988). That is, all privatization proposals run into immediate trouble because of the "double payment problem." This arises as a transition cost to pay for current retirees while shifting active workers over to an individual account (IA) system. According to Starr, a PAYGO system is locked in, except for the periods when it is accumulating large surpluses and taxpayers are paying partly for their own retirement. Starr refers to this period as privatization's "demographic opportunity," and it would seem that such a period is occurring now. For those of us who oppose privatization, we are in the "danger

zone," but most of us do not even know it. In essence, the Advisory Council's individual account proposals are an effort to privatize the social security "surplus," diverting some portion of this surplus into private accounts that would otherwise begin accumulating in a publicly held reserve to pay for part of the costs of the baby boom generation.

Pay-as-you-go financing has been a controversial subject since the adoption of social security. Not surprisingly, and true to Starr's forecast, supporters of privatization identify PAYGO financing as the "central problem with social security." They characterize PAYGO financing as "an income transfer system . . . rather than a retirement savings mechanism" (Advisory Council 1997: 103).

There is a deep historical irony in this debate over social security financing, since the fact is that social security in the United States was initially conceived as a partially funded system. The legislative decision to move toward a PAYGO system was negotiated in the 1939 amendments by conservative Senator Arthur Vandenberg, who feared that large social security surpluses would legitimize federal deficits or government control over private firms (Starr 1988). In short, the privatizers can thank one of their own for the transition cost dilemma.

One must admire the political acumen of Franklin Delano Roosevelt in creating a social security financing structure that has endured over 60 years. In my view, the political stability of the social security program is rooted in its lack of dependence on the federal budget. This provided the system with a cloak of political inviolability. But this too was almost not the case. Again, in another historical irony, the 1937–38 Advisory Council report envisioned an equal contributory role by the federal government. But this financing option was defeated.

Understanding Social Security's Long-Range Deficit

Looking ahead, it is clear that the subject of the social security long-range deficit of 2.19 percent of payroll requires more attention and understanding. The deficit, described in the 1996 Trustees Report, is at the crux of the Advisory Council report and the current debate over the solvency of the system. Interestingly, all three Council factions failed to analyze the deficit or its root cause.

One problem is that the social security system actually is projected to run surpluses indefinitely under the actuary's "low-cost" scenario. I raise this point because the "intermediate cost" scenario used by the Advisory Council relies on several questionable assumptions. For instance, it seems unreasonable to assume that economic growth will average only 1.8 percent over the next 20 years, a rate lower than any comparable period in the United States history. The "intermediate scenario" assumes that growth slows even further in later years, until the economy's growth rate is less than half of the

2.8 percent rate experienced over the last 20 years. Similar concerns can be raised about the conservative projections for future fertility and immigration rates (Baker 1996). One could readily argue that these key assumptions do not make sense in light of America's rebounding economy and tight labor markets.

A further concern about social security's projected deficits is prompted by a statement buried on page 163 of the Advisory Council Report. This Appendix, an insightful analysis describing actuarial experience of the Trust Fund since 1983, explains the source of the system's financial problems (Advisory Council 1996: 163–64). To many, this discussion will be surprising. Consistent with my earlier comments about overly conservative demographics, the actuarial report shows that demographic assumptions over the last 12 years have actually reduced, not increased, the social security deficit by 0.83 percent of taxable payroll. Moreover, the beneficiary/worker ratio has not changed since 1983 and has not contributed to the estimated long-range deficit. The actuarial report concludes that this fundamental ratio was fully taken into account in the 1983 financing provisions, so, contrary to popular opinion, demographics are not driving the social security long-range deficit.

Instead, other factors must be taken as causing the long-range deficit:

1. The shifting estimating period, accounting for 0.55 percentage points of the deficit.
2. The disability assumptions, accounting for 0.70 percentage points of the deficit.
3. Method changes, adding 0.93 percentage points to the deficit, and
4. Economic assumptions, accounting for 0.79 percentage points of the deficit.

Within the economic assumptions, the most important adverse experience was the steep decline in real wage growth from 1.5 percent to 1.0 percent, which by itself accounted for 0.50 percent of the deficit. Clearly, wage growth and social security's payroll tax financing system are inextricably linked. I believe that policymakers should be talking about the destructive wage stagnation of the 1980s and 1990s in light of social security's long-range financial balance, rather than social security privatization.

Defined Benefit (DB) Versus Defined Contribution (DC)

Organized labor believes that it is unacceptable to reduce social security's defined benefit plan design through partial privatization. Under the Personal Security Account (PSA) proposal, somewhat over 60 percent of the average worker's benefit would be based on a defined contribution account, and slightly less than 30 percent under the individual account proposal. It is

disingenuous for supporters of privatization to profess their support in the Council report for the "four-tier" retirement program resting on a compulsory social security system, when in fact their proposals act to replace the key DB foundation of the system (Advisory Council 1997: 17). The hallmark of the current social security DB plan is that it provides predictable income protection from the hazards of old age, disability, and death.

A major objection to privatization is that defined contribution (DC) accounts do not guarantee benefits. That is, the value of future DC benefits is determined by the capital market, which is inherently risky. In addition, there is always a risk of retirees having to purchase an annuity during a market downturn, and being forced to accept sharply reduced income. The reality is that social security privatization will not abolish the business cycle. Ultimate DC benefits are uncertain and not accurately quantifiable. Comparisons of replacement ratios, internal rates of return, and money's worth are of limited use when comparing benefits in a DB world, but are misleading when examining DC accounts.

Problems arising from movement to a DC format are exacerbated by social security's current inflation protection of benefits. To my knowledge, Wall Street does not broadly offer private investments that are guaranteed to keep up with future inflation. A dramatic expansion of government indexed inflation bonds in a privatization scenario would only shift the risk of inflation back to Washington (Advisory Council 1997: 17). Growing life expectancies also challenge the DC paradigm. The PSA group's proposed annuity voluntarism adds an additional layer of risk to privatization.

Equity Rates of Return: The Privatizer's False Solution

A common theme embraced by all Advisory Council proposals is the investment of trust fund or privatized assets in private equities. This is a dramatic departure from past financing practices of the social security system, and one with unpredictable macroeconomic consequences on interest rates, the federal deficit, the price of equities, and the rate of return on equities. We should note that the MB group did not advocate the near-term enactment of the equity investment proposal until further study was conducted.

What is also troubling about investing a portion of social security trust funds in equities is its potential deception and distortion of the real issues. It reminds me of my collective bargaining experience with employers who think they can fund their pension plans solely on investment returns without cash contributions. It's the false belief that you can "invest" your way out of a funding problem. I would submit that a bear market like the one in 1974–75 would end the privatization debate. Furthermore, Baker's study (1977) addresses some of the inconsistencies of the investment assumptions used by the Advisory Council. He questions the compatibility of projecting a real 7.0 percent annual return for stocks extrapolated from past historical

performance, with annual economic growth over the next 75 years at least two percentage points below what it was over the past 75 years. According to Baker, in order for stocks to continue to generate a 7 percent annual return under the trustees' assumptions of economic growth, price-to-earnings ratios would have to soar to an unheard-of 34 to 1 in 2015, and an absurd 485 to 1 in 2070 (Baker 1997). So much for investing our way into actuarial balance.

In the case of social security, equity investing and its superior rates of return have become the new panacea for policymakers, offering a way to avoid or reduce payroll tax increases. Whether it is politically correct or not, policymakers should not exclude payroll tax increases from their list of strategic options. Our social security taxes are still competitive with comparable industrial competitors, and gradual increases would not destabilize America's economic prowess.

The Privatizer's Agenda and Private Sector Pensions

After reading the Advisory Council report, it dawned on me that those who support individual accounts do not discuss how these would dovetail with the private-sector employer-sponsored retirement system. In fact, I would argue that social security privatization may result in replacing private sector pensions with IRA and Keogh-type accounts. Social security as it has been developed in the United States is the antithesis of privatization, promoting economic protection through a pooling of community resources. By contrast, privatization aims to separate the individual from the larger community. It is just as likely that privatization will separate the individual from the corporation or the union.

Historically, the social security program and the private pension system developed side by side. Social security did not "crowd out" the private retirement system as some theorists expected. Far from displacing private pensions, the social security program may have institutionalized the need for private retirement income. Unfortunately, private pension coverage has stagnated in the United States in the last two decades. This failure of private pension coverage to expand may have further emboldened the privatizers.

Organized labor strongly supports the current three-tier retirement income system. We believe that a social contract exists among the government, employers, workers, and retirees. In this way, organized labor rejects the anti-community message of privatization.

We can still return to the origins of our three-tier national retirement policy. We believe evolution is still under way, that policy mistakes have been made that can be corrected, and that the private pension and personal savings tiers need much work and enhancement. Undermining our current social security system would be a counterproductive move in American history. Instead, we believe it would be more effective to adapt and strengthen

the private sector retirement system. For example, private defined benefit plans should be targeted for deregulation and creative reform. Full-funding limits should be loosened. Congress must reorient itself towards supporting employer-sponsored plans and move away from its revenue-driven fiscal policies. Policymakers should also promote more innovation and flexibility in DB plans, such as provisions for employee contributions and partial phase-out retirements. The tax advantages of private pension plans should not be weakened.

Public opinion surveys indicate that workers are expecting to depend much more on their own retirement savings and their employer's pension plans than on social security in the future (Rother and Wright, this volume). If these expectations are to be realized, and if workplace conflict is to be avoided in the twenty-first century, here is where the work needs to be done. Privatizing Social Security is not the solution to our national retirement problems. Promoting and expanding private pension plans presents safer opportunities for policymakers to enhance our retirement system.

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