Next Social Contract Initiative and Economic Growth Program

Competing Visions of the Past

Learning from History for the Future of American Social Policy

Steven Attewell, PhD Student, Policy History, University of California-Santa Barbara

December 2012

In his 2012 nomination acceptance speech in Charlotte, President Obama argued that this election represented "a choice between two fundamentally different visions for the future." It is also true to say that we faced a choice between two fundamentally different visions of the past. And despite Obama's reelection, the debate rages on in a closely-divided electorate and in Washington. Underneath disagreements over Obamacare, Medicare advantage cuts and Medicare vouchers, and individual retirement accounts, there is an argument about which model of social policy is best for the country.

Broadly speaking, the current debate revolves around three models of providing support to our citizens – employer-based benefits, individual accounts, and social insurance – that have been tested in the past, and yet there has been very little attention paid to our historical experience. When history can tell us which of them worked and which didn't, we should pay more attention to these lessons. By learning from this history, we can determine how to craft better social policy for the future.

The Rise and Fall of Employer-Based Benefits

Whether we look at defined benefit pensions, employer-subsidized health insurance, or paid leave and vacation time, American social policy depends on the existence of employer-based benefits so axiomatically that it's easy to forget how historically recent and fragile our uniquely private social insurance system is.

As Sanford Jacoby and other historians have shown, "welfare capitalism" originated at the turn of the 20th century for the specific purpose of warding off outside influences that might interfere with their employees' loyalty and dependence on their employers. On the one hand, employers had to contend with "friendly societies" run by unions or other associations that offered funeral benefits, widows' pensions, sickness and unemployment insurance, and banking and credit services.[1] Comprising some five million members by 1920, these welfare funds offered workers some limited economic independence from their employers, and in the case of trade union friendly societies, a powerful incentive to join unions. On the other, the rising Progressive movement had thrust European-inspired social insurance onto the national agenda. In 1905, the formation of the American Association for Labor Legislation brought together Progressive academics and public intellectuals into a sophisticated lobbying organization that fought for model social insurance legislation on a state-by-state basis, introducing bills for sickness insurance

in three state legislatures in 1916 and eleven more in 1917.[2] The 1912 Progressive Party platform endorsed national social insurance for the sick, the elderly, and the unemployed – bringing the issue to a level of prominence it had never before enjoyed.

In order to ward off these threats to their dominance over their workforce, a group of employers began to offer benefits to their workforce as a voluntary "Third Way," part of a larger "American system" that also included the introduction of company unions, personnel departments, and other seemingly benevolent measures. By 1914, 2,500 firms offered some form of limited benefits – cafeterias, employee housing, athletic leagues, and types of profit-sharing in the first wave, with retirement pensions and unemployment benefits becoming more prevalent later on.[3] These firms were hardly typical; early adopters of welfare capitalism tended to be large industrial corporations, especially founder-owned companies, with heavy concentrations in the railroad, locomotive manufacturing, steel production, and tire industries.[4] The benefit programs they offered were specifically designed to give them the most discretion possible in which employees got benefits, and what level and form of benefits they would receive, which in turn maximized the need for employees to remain on good terms with their employees. Even within a single firm, programs weren't intended to be universal; rather, they were specifically targeted at skilled workers who were believed to be the most open to trade union organizing or to a competitor's job offer, and to make sure that those workers had every incentive to remain in their current jobs.

Welfare capitalism exploded during and immediately after World War I, as employers like Bethlehem Steel, Western Union, AT&T, DuPont, Westinghouse, and General Electric sought to preserve what they called "communal harmony" in the face of record levels of labor organizing, industrial strife and the intervention of the newly-minted War Labor Board by increasingly offering tangible benefits like pensions, insurance, and profit-sharing. Like earlier pioneers, employers who jumped on the welfare capitalist bandwagon during and immediately after the war tended to be concentrated in industries and firms that were capital-intensive with low labor costs, and especially those that enjoyed above-average levels of profit and steady demand for their product – which meant offering benefits was more affordable than in labor-intensive, low-margin industries.[5] As before, however, benefits remained limited, contingent gifts of the employer, with only 2% of the workforce covered by formalized group insurance plans by 1929.[6]

The Great Depression profoundly transformed the world of welfare capitalism and revealed the extremely weak financial foundations of employer-based benefit programs. With the collapse of 100,000 American employers between 1929-1933, many workers found the retirement and health care benefits they were relying on had disappeared along with their jobs. Many others whose employers didn't go under saw their plans cancelled as employers sought to reduce costs by any means necessary.

Welfare capitalism didn't die, even as major firms like U.S Steel, Ford, Armour, and International Harvester jettisoned their programs.[7] Two factors preserved employer-based coverage: first, insurance companies began to offer group plans for disability, old age, and life insurance to employers, which lowered administrative overhead and allowed for a rationalization of costs of the long term.[8] Second, the traditional friendly societies that might have flooded in to compete had fractured under the same pressure of increasing benefit claims, declining numbers of payees, and underfunded reserves.[9]

Employer-based benefits did, however, face an intensified threat from the new industrial unions and the emerging New Deal state. As Jenn Klein notes in *For All These Rights: Business, Labor, and the Shaping of America's Public-Private Welfare State*, the emerging Congress of Industrial Organizations (CIO) didn't stop at endorsing the New Deal's social policies. Instead, inspired by union leaders with syndicalist tendencies like John L. Lewis and Sidney Hillman, the CIO also pursued a

modernized version of friendly societies, founding union-owned insurance companies, banks, and housing cooperatives. In the field of health care, both CIO and AFL unions approached a strategy in which they simultaneously pushed for the addition of health insurance to Social Security and constructed a network of health centers and health plans, open to both union workers and unorganized members of the community. Unions negotiated with groups of doctors to agree on a set monthly fee for medical services, frequently offering both community rating to equalize premium levels and progressive dues set at a percentage of family income.[10] Their ultimate aim was to create a system of health provision independent of employers but friendly to the New Deal state, which they hoped would initially offer financing for construction of health centers or even subsidies for their health care plans as a foundation for national health insurance.

The high-water mark of this campaign came in 1946. John L. Lewis led the United Mine Workers out on strike to win a union-controlled Welfare and Retirement Fund offering a full suite of health care, retirement, and unemployment insurance through union dues and a mandatory employer contribution. The UAW, which had built up its own system of union-run rehabilitation, unemployment, and old age benefits and had made contracts with doctors' groups for medical services coverage, demanded a flat 3% of payroll contribution from employers to run their social insurance system in the 1946 contract campaign.[11]

Employers, especially in the steel, rubber, auto, electrical, and oil industries, fought back with a vengeance to preserve their position. One major strategy they arrived at was to unilaterally establish group insurance programs offered to them by commercial insurance companies and new health insurance organizations like Blue Cross, in order to preempt union-run plans and keep employee benefits under their control while still maintaining that employer-based benefits were a "gratuity" offered by the employer and thus not a subject of bargaining. Thus, while pension and health insurance programs exploded both on the union and employer-based side, the ultimate question of who would control social provision would depend on that other threat to employers, the New Deal state. If the New Deal state preferred either union-controlled or employer-controlled programs when it came to collective bargaining, tax subsidization, or incorporation with Social Security, that model of social provision would likely become dominant; if the New Deal state's policies instead privileged state-based provision over either, the state might eclipse both.

Despite a brief period of cooperation during the first few years of the New Deal when the National Recovery Administration brought business and government together to stabilize prices and wages, employers came to view the federal government as a threat to their independence the moment that the Roosevelt Administration attempted to implement NRA codes empowering workers to form unions. The 1935 Social Security Act was seen as an even more dangerous threat. National old age insurance, paid for by a payroll tax levied on and collected by employers through withholding, threatened to make private pensions obsolete and rob employers of one of their chief tools to keep workers (especially skilled workers) tied to the company for life. Unemployment Insurance further sought to interfere with "management prerogatives" by varying tax rates in order to penalize employers who relied on cyclical layoffs to keep down labor costs. Employers sought to ward off this threat, first by lobbying for an exception for employers who offered private pension and unemployment programs, and when that failed, by challenging the Social Security Act in court.

To an extent, taxation and regulation had always shaped the course of employer-based benefits. IRS decisions and Revenue Acts in the 1910s and 1920s had been useful for welfare capitalists (by excluding employer contributions to accident insurance, life insurance and pension payments to current retirees from corporate income taxes, as well as deferring taxes on pension trust assets until receipt of benefits), and corporate tax rates were low enough that employers didn't really have to worry about the tax

bill on their benefit systems.[12] However, once the higher corporate tax rates of the New Deal and World War II began to take more of a bite, finding some way to reconcile welfare capitalism with the New Deal's social insurance system became paramount.

At the last minute, employers managed to avoid Social Security replacing their private pension programs outright as the rough outlines of a compromise emerged. The Revenue Act of 1942 allowed employers to "integrate" their private pensions with Social Security by counting workers' Social Security benefits against what the employer would normally owe. When added to a 1939 law that allowed private pension income to be free of income and Social Security taxes, this dramatically reduced the cost of covering blue collar workers whose retirement income would be largely made up of Social Security with a supplemental benefit from their employer, while allowing employers to concentrate their own finances on larger pensions for their skilled, higher-paid workers.

In exchange for this, New Dealers extracted requirements that employers had to open up pension coverage to the bulk of their workforce instead of to a privileged few, requiring a minimum of 50% of the workforce covered in order for pensions to qualify for Social Security "integration."[13] As a result, private pension coverage, which had been stuck at about 5% of the workforce from 1915-1930, dramatically increased to about 40% of the workforce in 1965. A 1943 IRS decision to allow group health insurance contributions to be untaxed likewise lowered the costs of providing health insurance, and led to a similar expansion in private coverage.[14]

Another compromise emerged when it came to the question of union plans versus employer plans. While the National Labor Relations Board (NRLB) and the National War Labor Board (NWLB) restricted employer power by empowering unions to organize and collectively bargain with employers over union recognition, wages, and grievance systems, the two trod a much more cautious path on "fringe benefits." The National War Labor Board initially refused to impose mandatory insurance programs and instead guaranteed existing (largely employer-based) plans, while allowing employers to unilaterally impose pension and health care insurance.

It was only after 1943, when the NWLB excluded employer payments to insurance plans from the wage freeze (thus creating an enormous incentive for employers to add expanded benefits to collective bargaining in lieu of wage increases) and later mandated the inclusion of insurance in new agreements, that the principle was established that employer-based benefits would have to be negotiated with unions, creating something of a mix between the old welfare capitalism and union benefits. The hegemony of the new collectively-bargained private insurance system was cemented when the Taft-Hartley Act of 1947 banned retirement and welfare programs operated solely by unions, derailing the attempt of the UAW and UMW to create an independent social security system.[15]

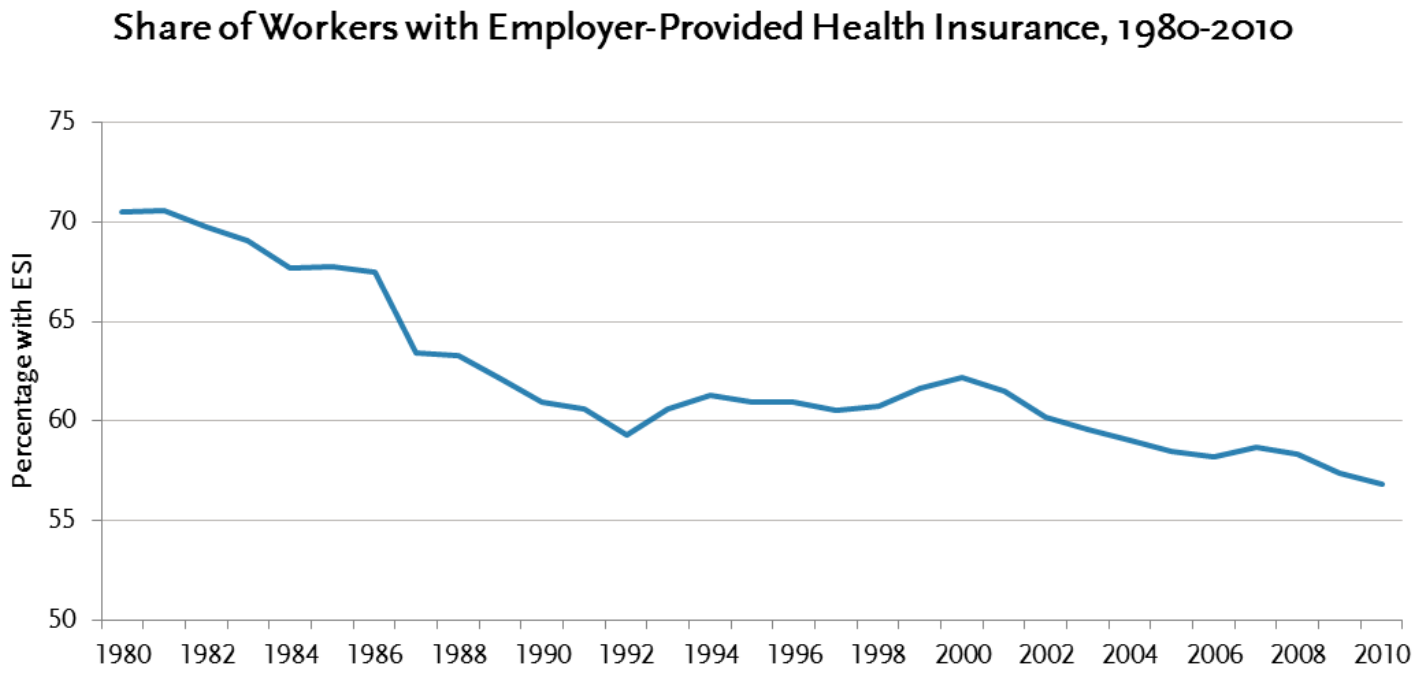
The larger point is this: employer-based benefits have always relied on public subsidies and regulations that give them access to tax subsidization and protection from being totally overwhelmed by either union-controlled plans or social insurance, and on a particular economic structure in which large employers, heavily based in manufacturing and industry, could afford to take on an additional economic burden in the name of maintaining employee loyalty and dependency.

When that stopped being the case, a crisis in employer-based social provision was bound to occur.

The Future of Employer-Based Benefits

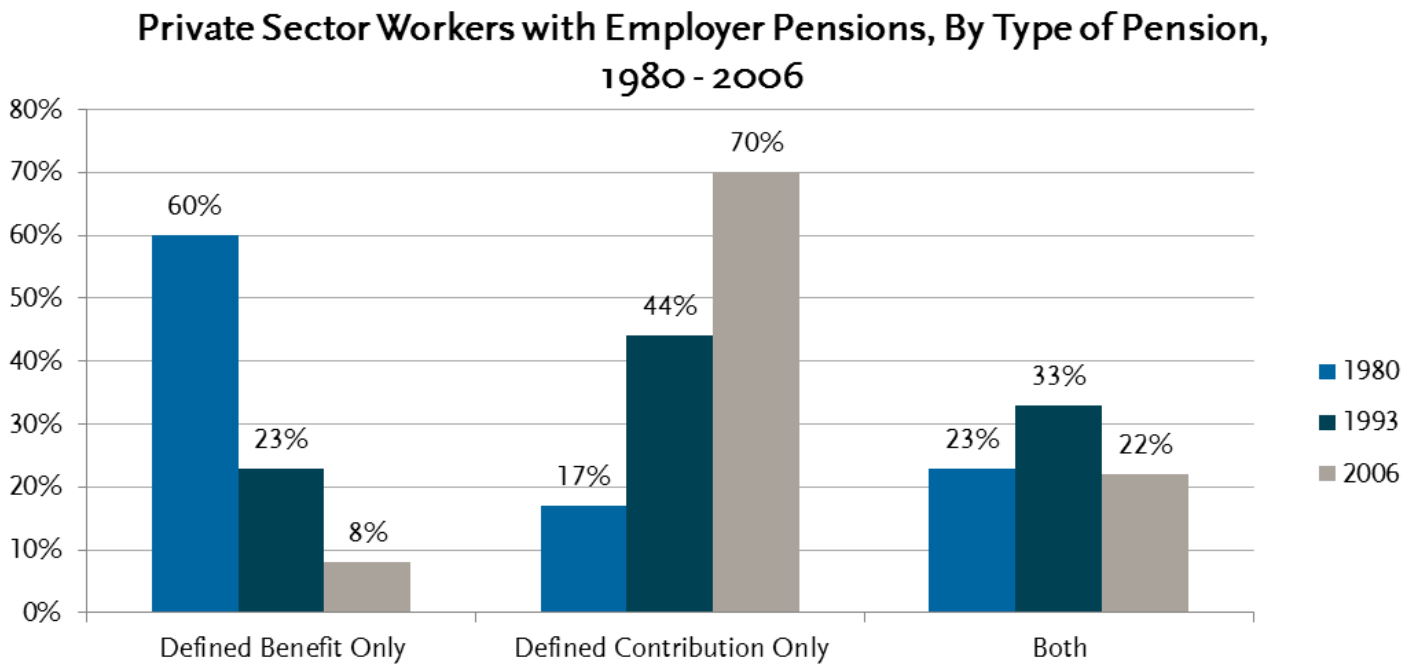
As we can see from the charts below, employer-based social provision worked for a broad segment of the population once upon a time. In 1980, about 70% of people under age 65 had health insurance and about 60% defined benefit pensions through their employers. However, over the last 30 years, the shifting of the American labor market (along with decisions by employers to jettison employee benefits in the name of competitiveness) has led to a marked decline in coverage – in 2006, only 58% of people under 65 had employer-based health insurance and less than 30% had access to defined benefit pensions.[16]

Moreover, these figures show decline becoming more and more problematic. While remaining roughly steady between 1975 and 1986, and declining by 8.2 percentage points between 1986-1992, coverage mostly recovered during the 90's boom. However, since 2000, employer-based health coverage has declined nearly every year, both in recessions and recoveries. It is possible that the ACA's employer mandate may change this trend, but any reforms will be swimming against a strong current running in the opposite direction. When we look at the ten occupations projected by the BLS to have the most new jobs through 2016, on average only 47% offer employer-based health insurance, and only 37% defined benefit pensions.[17] Recent research also shows that in the last decade alone, the percentage of workers without access to any employer-sponsored retirement plan rose 21%.[18]



Data: John Schmitt and Janelle Jones, Center for Economic and Policy Research

And yet, most of our recent health care reform efforts of the last twenty years have been built around employer-based provision of health insurance. The failed Clinton health care reform was based on a joint individual and employer mandate along with subsidies. Ironically, much of the controversy over premium caps and mandatory participation of employers, insurers, and providers to participate in regional cooperatives (let alone the individual mandate) had little to do with coverage and more to do with the role of employers and whether they would continue to offer insurance if burdened with new regulations.



Source: Center for Retirement Research at Boston College

The Massachusetts health care reform passed under Governor Mitt Romney was similarly based on a "play-or-pay" mandate on employers with more than 10 employees (who had to either have an employee plan at least covering 25% of their full-time workforce or provide at least 33% of premium costs for outside insurance) and an individual mandate to purchase health insurance. A further "free rider" surcharge on firms that did not establish a payroll deduction system for health insurance (which in turn would make running an employee insurance program much easier) further illustrates how critical universalizing employer-based insurance was to "Romneycare."

Finally, the Affordable Care Act follows much the same "moderate" blueprint in regards to private insurance. In addition to the more controversial individual mandate, firms with more than 50 workers will have to either provide health insurance to their workforce or pay a "shared responsibility" fee for every employee whose insurance the government had to subsidize; small businesses are offered subsidies to purchase insurance for their employees. Employer-sponsored plans and individual plans alike will face new regulations to ensure minimum standards of coverage and medical care per premium dollar, that preventative services (especially women's health services and contraception) are provided without co-pays and deductibles, and that insurance provides a minimum level of services for premium dollars.

Despite this common thread, all of these attempts to grapple with American health care faced and continue to face the difficulty of sailing into a prevailing wind of the decline of employment-based health insurance.

This shouldn't come as a surprise to anyone. If employment-based insurance has always depended on public subsidies and on a particular model of economic growth, long-term trends in the economy don't bode well for its success. To begin with, we've seen a secular shift in the U.S labor market towards increased use of casual, part-time and temporary labor, as employers seek to offload economic risks on their employees. Given that most employment-based benefits require minimum tenure (both in terms of months of employment and hours per week), fewer employees will be covered even by employers who maintain health

plans. Similarly, the long-term trend toward increasingly persistent and sharp recessions will increase demands on employer-based programs that spread costs over fewer and fewer workers.

All of this raises the question: given that employment-based coverage was designed to allay political opposition to changing the status quo and to provoke less controversy than government-provided health care, does the strategy still make sense if people with employer-based health insurance will cease to be the majority of the electorate in a few years, and individual and employer mandates no longer have bipartisan appeal in the think-tank world, the Republican Congressional Caucus, or in the electorate?

Clearly not. Health care reform is not going to go away as a political issue, even after the last provisions of the ACA come into effect. Thanks in large part to the Supreme Court's decision in *NFIB v. Sebelius* to allow states to opt out of Medicaid expansions, there will still be 31 million Americans (or 10% of the population) without health insurance. Policymakers will need to develop new plans to finally universalize health coverage, maintain quality of care, and reduce the growth of health care costs, which means they will have to move away from employer-based insurance.

The Trouble With Individual Accounts

To the extent that a conservative model for social policy still exists following the collective decision of the right to demonize the individual mandate model originally drawn up by the Heritage Foundation in the 1990s, it's the idea of individual accounts.

The argument for individual accounts as a model for social policy began in the early 1980s as a reaction to Reagan's failure to muscle through cuts in Social Security and the successful effort of Tip O'Neill to ride the "third rail" to a working majority in the 1982 midterms. Recognizing that Reagan's election hadn't quite brought about the popular rejection of the welfare state that they had hoped, Peter Ferrara of the Cato Institute synthesized ideas coming from Arthur Laffer, Peter Drucker, and other conservative economists into a plan to replace traditional Social Security with private, individual savings accounts. Ferrara's plan bent to pragmatic reality by retaining traditional retirement benefits for existing and soon-to-be retirees, while requiring younger workers to fund their own retirement accounts and purchase private disability and health insurance.

Stuart Butler and Peter Germanis of the Heritage Foundation took up the political side of Ferrara's vision by proposing a generation-long "Leninist Strategy," in which conservatives would divide the pro-Social Security coalition by protecting seniors while selling the young on individual accounts. Meanwhile, they would eliminate as much as possible of Social Security's universal and redistributive elements. The next step, they argued, would be to build up a new anti-Social Security coalition explicitly financed by the financial services industry by bringing together movement conservatives together with protected seniors and "aspiring" young people.

Despite a sequence of failures to mobilize the supposedly more pro-market, individualist 80s Yuppies and 90s Generation Xers to vote for privatizing Social Security, advocates for individual accounts were buoyed by the growth of IRAs between 1982-86 (when an IRS decision allowed IRA participants to sock away more tax-free dollars), and the even more impressive explosion of 401(k)s starting in the late 80s, the decline of traditional defined benefit pensions, and the seemingly eternal rise of the stock market in the 90s. Even if Social Security was still untouchable, the cultural playing field seemed to be tipping in favor of establishing individual accounts as an explicit alternative to Social Security.

Interestingly, while corporate funding and funding from wealthy businessmen had been forthcoming from the beginning of the individual accounts movement, the financial services industry was slow to embrace privatization as a source of profits as opposed to an ideological commitment. Initially, the financial services industry was politically motivated by the fear of inflation and volatile interest rates, which financiers like Pete Peterson believed were the result of government spending. In order to preserve financial stability, bond marketeers wanted to maintain stagnant wages and balanced budgets while promoting increased rates of individual savings to power growth – and replacing Social Security with private accounts seemed an excellent way to achieve all of these goals simultaneously.

Gradual changes in the financial services industry opened the door to a self-interested embrace of privatization: the abolition of fixed commissions by the SEC in 1970s, with a resulting shift of profit centers from underwriting to fees-generation; and especially the expansion of IRAs and 401(k)s at the expense of Defined Benefit pensions, which resulted in dramatic growth in the mutual funds market from $15 billion in 1975 to $1.5 trillion in 1992.[19] The new financial services industry required a constant pipeline of financial transactions to generate fees off of, and given how extreme shifts in volume of stock trades could be, Social Security seemed a uniquely steady source of revenue because of its public nature.

Thus, Wall Street was primed to respond to the entreaties of the Heritage Foundation, Cato's Project on Social Security Privatization, Peterson's Concord Coalition, and a whole host of accounts advocates, especially when the growth of the Social Security Trust Fund in the late 90s promised to bring in $100 billion in new revenue (increasing the size of the mutual funds market by one-fourth to one-half). By charging 1.94% in administrative expenses (about 60% more than Social Security's administrative overhead) and tacking on additional fees for annuitization and other transactions, the financial services industry could extract $12.5 billion a year in profits.

Beginning in the 1990s, individual retirement accounts surmounted a crucial barrier by moving from campaign rhetoric to bills introduced in Congress with the 1994 Kerrey-Danforth plan that emerged out of Clinton's Social Security Commission, and the 1995 Kerrey-Simpson Bill.[20] Both proposed increasing the retirement age to seventy, "adjusting" the CPI to slow cuts, reducing cost-of-living increases, and allowing workers to divert up to a third of their payroll tax into an individual retirement account. Despite opposition from the majority of the Democratic Party, Clinton remained a behind-the-scenes advocate of a bipartisan deal on Social Security and was willing to pay heed to individual accounts until 1998, when the Republican impeachment made Clinton reach for "Save Social Security first" and opposition to privatization as a popular club to beat his Congressional opponents.

The ascension of George W. Bush, an early and outspoken advocate of privatizing Social Security through individual accounts, to the presidency with Republican majorities in both houses of Congress brought the movement closest to passing individual retirement accounts into law. However, the drive was immediately complicated by the competing conservative drive to push for $1.2 trillion in tax cuts, which ate much of the surplus that could have cushioned the enormous transition costs of establishing these accounts. As a result, the proposal for individual accounts promoted by Bush's 2001 Social Security Commission required benefit cuts of 48% and $100 billion a year in transfers from the Social Security Trust Fund to make the numbers work, hardly the "free lunch" advocates had been describing for twenty years.

Combined with the 2001 stock market crash and the wave of corporate scandals that emerged after the fall of Enron, popular support for such a proposal was no longer in the offing and the plan was quietly shelved until after the 2004 election. In his

2004 State of the Union, George W. Bush infamously cashed in his political capital and made individual accounts his number one domestic priority. However, in spite of a nearly $3 million strong road trip in 2005 aimed at pressuring conservative Democratic Senators whose red states he had won in 2004, Bush's efforts to break through in the Senate backfired in the face of rising public opposition (while 58% of Americans expressed support for private accounts in September 2004, by February 2005, 58% opposed individual accounts vs. 34% in favor).[21]

The one place where George W. Bush succeeded in making the individual account movement's agenda law was in the realm of health care, where private Health Savings Accounts (HSAs) and Medicare Advantage were established as part of the Medicare Part D bill enacted in 2003. While Medicare Advantage more resembled private group insurance than individualized accounts, opponents of social insurance hoped it would work as a thin end of the wedge on privatizing Medicare, while focusing on the virtues of HSAs. Like the IRAs and 401(k)s created in the 1970s and 80s, Health Savings Accounts were individual accounts used to pay for high-deductible private insurance (with a minimum deductible of $1,200 for an individual and $2,400 for a family), and now offered both tax-free contributions and withdrawals (an earlier, less popular Medical Savings Accounts merely allowed for tax-free withdrawals). Back in 1983, Ferrara had hoped that these kinds of accounts would begin to disentangle the reciprocal solidarity built into Medicare and create a new anti-Medicare constituency; since the failure of the Clinton health care plan in 1994, hard-right conservatives (as opposed to the more moderate pro-mandate conservatives) had also argued that HSAs would give Republicans a solution to the growing problem of rising health care costs by imposing market discipline on health care consumers with "skin in the game" and thus reducing demand for medical services.

Historical Outcomes of Individual Accounts

Despite the hopes of privatization advocates, individual accounts have been disastrous failures everywhere they've been tried. The example of Chile's individual retirement account system, promoted by privatization advocates since its inception in 1981, went horribly wrong almost from the beginning. To begin with, in order to finance transition costs that have run to 5-6% of GDP per year, the Chilean government has had to establish a value added tax, cut social expenditures, increase the age of retirement, and dramatically increase government debt levels, and even then will only finish making the transition in 2050.[22] Secondly, given high management fees that rise to as high as 16-20% of annual contributions (with annuitization costs adding another 8-9%), the high rates of returns touted by pro-market forces have been cut to an average of only 0.3%.

When the Chilean market turned down in 1994, the system began to fall apart – one-half of the funds managing individual accounts made losses that year, and "between 1995 and 1998 returns were -2.5%, 3.5%, 4.7%, and -1.1%."[23] These losses forced the Chilean government to sink $66 billion into pension payments in order to bring millions of pensioners up to a minimum of $140 a month,[24] and unsurprisingly, Socialist President Michelle Bachelet pushed through a major reform of the system that turned away from private accounts to establish a Solidarity Pension to guarantee a minimum income to the poorest 60% of the population.[25]

Likewise, Thatcher's partial privatization of Britain's supplemental pension system much touted by privatizers has been a major failure. Thatcher's reforms cut the state-run supplemental pension replacement rate to 20% and provided a 2% tax rebate to those who switched into Appropriate Personal Pensions (APP), leading to 4 million people switching out of the state-run program, which cost the British government £9 billion in unforeseen transition costs and zeroed out a surplus in the National Insurance Fund.[26] As was the case in Chile, management fees (including management expenses of 2.5% per year, fees for

switching providers or failing to make payments, and annuitization rates) eat up 43% of individual contributions on average.[27] A major scandal in the 1990s in which managers provided suspect advice to savers saw one-third of individual accounts holders lose a combined total of $20 billion in pension assets. Altogether, the combination of cuts to state pensions and the low return after fees is projected to leave 33% of the elderly living in poverty by 2050. [28]

Similar outcomes have been found in Argentina, Bolivia, Slovakia, Poland, Romana, Latvia, Lithuania, and Estonia: individual accounts are poor vehicles for retirement security because inequalities of income lead to inequalities of contributions, high management fees cancel out stock market returns, and financial scandals and market crashes can wipe out built-up assets for those unlucky enough to retire in the wrong year.

On the health care front, where activists actually managed to create an individual account system in this country, the results haven't been much better. However, while HSAs have grown to about 13.5 million users, they've yet to come close to the 100 million people covered by government health insurance, let alone the 170 million people covered by traditional employer-based group insurance, and are unlikely to grow much further or have a significant effect on health care costs.

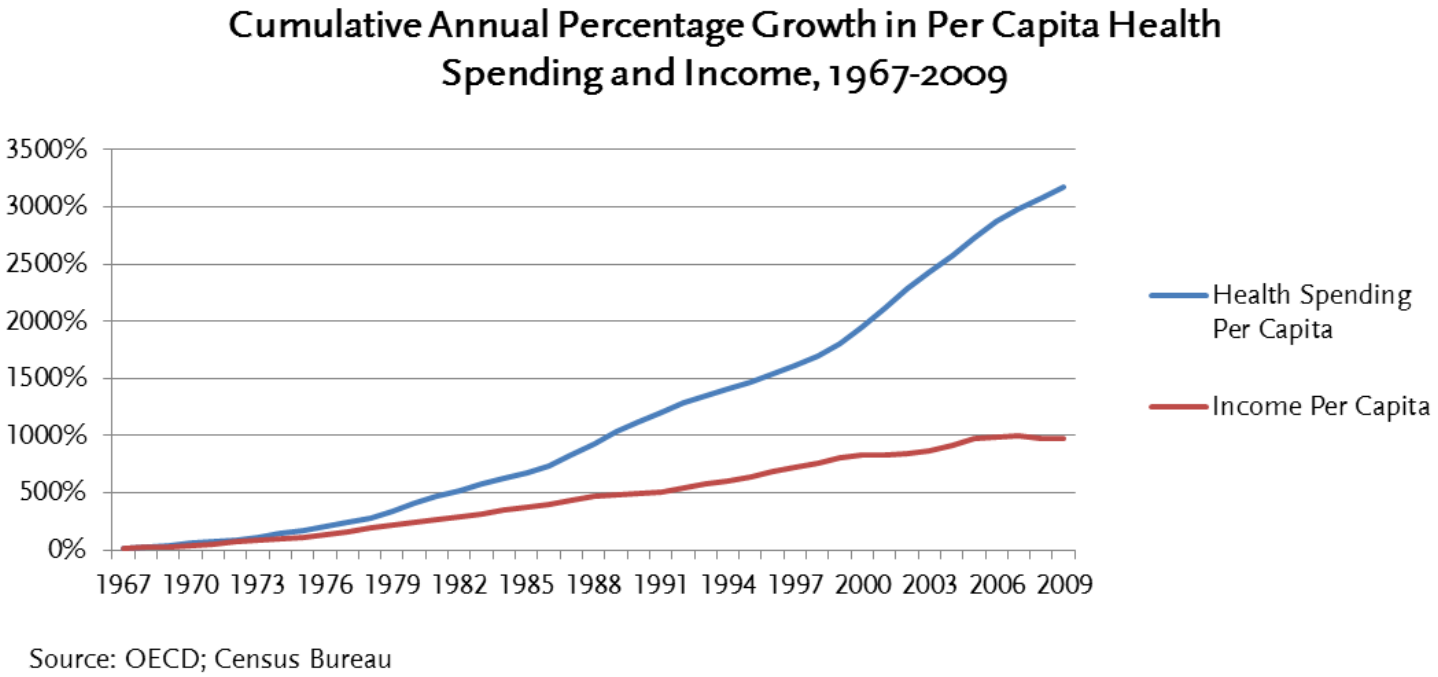
The reason individual accounts don't work in the realm of health care has to do both with the distribution of health and wealth in America. 70% of health care users in the United States spend less than $1,000 a year because they're largely healthy and don't have to deal with a chronic condition, functional limitation, or a catastrophic medical event. These people wouldn't really benefit from a Health Savings Account because they're already spending less than the deductible. The 5% of users who account for 50% of personal health spending have such high and continuing health care costs that they would blow through the $3,000 yearly deposit limits on HSAs almost immediately – 92.6% of them have a chronic condition and 62% of them have some form of functional limitation. This leaves 25% of users who spend more than $1,000 a year who might benefit from HSAs. However, it turns out that "putting skin in the game" actually increases health care costs, as patients avoid preventative care and routine checkups to save money, which makes them more likely to develop more expensive catastrophic conditions.

This reality of American health care is layered on top of the existing problem of high and increasing income inequality. In order to contribute to HSAs, users need several thousand dollars a year in post-living expenses income to save, and most people don't have that; as the legendary social insurance advocate Isaac Rubinow once said, "the assertion that, in the case of the wage-earning class, individual saving may solve the problem of poverty, necessarily supposes the existence of a surplus in the budget of the average wage-earner's family."[29] It's no accident then, that the average gross income of HSA users in 2008 was $139,000 a year, two-and-a-half times that of non-HSA users.[30]

Therefore, HSAs can't replace traditional social insurance, nor can they make much of a dent in health care costs. However, what they can do is further decouple the younger, healthier, and more affluent from group insurance in general, which conservatives hope will make these people turn against the Medicare taxes imposed against them in the same way that IRAs and 401(k)s were intended to build an anti-Social Security constituency. HSAs can also allow employers to ditch their traditional private group insurance plans and dump health care costs onto their workers, which will ironically break down the largest form of private health coverage in America while accelerating the pressure of rising health care costs on even larger numbers of Americans, potentially swelling the constituency for universal public health insurance.

When it comes to HSAs, the basic problem is that health care is by nature a failed market. It's impossible for the layperson to anticipate his or her future health care needs (and even with frequent diagnostics and checkups, the use of actuarial tables, or DNA analysis, extremely difficult). Moreover, many of the most expensive health care costs arise in situations that leave the consumer unable to exercise economically rational behavior (it's hard to price health care options when you're wheeled into an emergency room), and in non-emergency situations, consumers lack the medical expertise to choose between competing alternatives.

Even if it were possible to be economically rational about health care, the problem is that individual incomes aren't growing nearly enough in comparison to health care costs to allow most consumers to save enough money.



Source: OECD; Census Bureau

We see the same thing in retirement accounts. 75% of Americans nearing retirement had less than $30,000 in their retirement accounts. It takes twenty times one's yearly income to maintain current living standards, or $500,000 to maintain the median wage.[31]

The Foundations of Social Insurance

Since the beginning of the 20th century, social insurance has been the keystone of progressive efforts to provide economic security and ward off poverty. The Committee on Economic Security called together by Franklin D. Roosevelt in 1934 to deliberate over the creation of a social insurance system that could ease the country's economic crisis and protect it from a future Great Depression was staffed by many veterans of the failed attempts to pass social insurance legislation during the 1910s and 1920s and by those who had succeeded in establishing state-level social insurance in Wisconsin in 1932. The result was the convening of competing Progressive ideas on social insurance.

Advocates for actuarially-sound prefunded systems squared off against those who preferred a pay-as-you-go approach to avoid the deflationary effects of building up reserves through taxes in a depression. Those who preferred social insurance taxes to be levied at the level of individual firm so that rates could be varied in order to push industrial employers to regularize employment quarreled bitterly with those who favored a flat rate of taxes pooled across the entire economy that would allow better cross-subsidization between wealthier and poorer workers. Representatives from the Children's Bureau drew up plans for a national "mothers' pension" system, while public health advocates from the Julius Rosenwald Foundation drew up a scheme for a joint federal-state health insurance system.

The ultimate result of their deliberations was a system designed as a social contract between all members of society to protect one another from all of the "vicissitudes of modern life," of which old age was but one element. The draft legislation that FDR's brain trust envisioned contained sections that were designed to protect specific populations from the risks each typically faced. Taken together, the provisions were designed to stretch a safety net underneath the whole of American society.

Old Age Insurance would provide a retirement pension – but only for the 46% of the American workforce that was securely attached to the industrial economy. For the majority of workers, including all agricultural and domestic workers (which meant the vast majority of African Americans and women), those who fell into poverty in old age would be provided benefits through Old Age Assistance (OAA), a joint Federal-state welfare program for the elderly (that was rolled into the Federal Supplemental Security Income (SSI) program in 1971). Women and children who had lost their (male) provider would receive welfare benefits through Aid to Dependent Children. Adult workers would be protected against a sudden loss of wage income by Unemployment Insurance, but as was the case with Old Age Insurance, only 46% of the workforce would be covered.

Despite these limitations, activists within the Social Security Administration as well as Congressional Democrats from the Party's liberal and moderate wings pushed repeatedly to expand social insurance in the direction of universal protection.

Over the next 40 years, the Social Security system was amended repeatedly to expand eligibility, raise the level and variety of benefits, and establish innovative programs to cover new populations. In 1939, Congress established Survivor's benefits and expanded Aid to Dependent Children, thus bringing most women under the umbrella of Social Security. In the same amendment, regular Social Security benefits were accelerated and a Trust Fund was established which allowed the system to support a higher benefit level. In 1956, agricultural and domestic workers were added to the rolls of the eligible, bringing the majority of African-Americans within both Old Age and Unemployment Insurance. In the 1960s, amendments created Disability Insurance and raised benefit levels once again. In 1972, Social Security benefits were indexed to inflation with a permanent COLA (Cost-of-Living Adjustment), and the old OAA system was rolled into Supplemental Security Income two years after.

In the realm of health care, activists waged a thirty year struggle to include medical and hospital insurance, following stalemate with the American Medical Association on the 1935 Rosenwald Plan. In 1939, Senator Wagner (author of the Social Security and National Labor Relations Acts) introduced a National Health Act to establish joint Federal-State universal health insurance, only for the bill to die in committee thanks to an alliance of Southern Democrats and conservative Republicans. A similar fate was meted out to the Wagner-Murray-Dingell Bill proposing Federal public health insurance, unemployment insurance, and poor relief in 1943, 1945, 1946, 1949, and so on. In 1965, the passage of Medicare and Medicaid finally broke through the firewall of opposition from conservatives and the American Medical Association to add health insurance to the suite of social insurance

programs covering the elderly and poor. Both in 1974 (with the near-passage of Nixon's Comprehensive Health Insurance Plan and the Kennedy-Mills Bill) and 1979 (with the introduction of dueling Kennedy and Carter proposals for national health insurance), the U.S came close to including health care within the sphere of social insurance.

Historical Results of Social Insurance Programs

Despite thirty years of attempts to downplay the virtues of Social Security and to invent a narrative of greedy seniors and oncoming crises, along with the attendant drive to cut Social Security to the bone to save Social Security, the reality is that Social Security has reduced elderly poverty from above 50% in 1935 to less than 10% today.[32] When we look beyond Old Age Insurance to consider social insurance more broadly, we find that 47.9% of pre-transfer poverty in America is eliminated by social insurance.[33] Likewise, when we look at health insurance, Medicare and Medicaid cover 15.2% and 16.5% respectively of the U.S population, and when all forms of government health insurance are included, 32.2% of the U.S receives health care through some form of government-provided program.[34]

Given this history, it's not surprising that efforts to roll back social insurance or to reduce its benefits have repeatedly failed in the last thirty years, despite the rise of an elite consensus that social insurance should be eliminated, reduced, or privatization.

Attempts to Reduce Social Security Since 1980

Proposal	Changes	Outcome
1981-1982 Reagan-Stockman Plan	Cut cost-of-living adjustment (COLA) Increase penalty for early retirement $75 – 100 billion in cuts over 5 years	Fails in Senate
1983 COLA Reduction	Cut COLA entirely for '83	Dropped in Senate
1983 Amendments	Reduction in COLA Adjust CPI Increase in payroll tax Increase retirement age	Passed into law
1988 COLA Reduction	Reduction in COLA	Dropped in budget negotiations
1995 Kerrey-Danforth Commission	Increase retirement age Adjust CPI Cut COLA Promote individual accounts	Commission fails to achieve consensus
1995 Kerrey-Simpson Bill	Increase retirement age Adjust CPI Cut COLA Promote individual accounts	Died in Senate Committees
2001 Moynihan-Parsons Commission	Promote individual accounts	Commission recommendations not picked up
2005 Bush Privatization Effort	Promote individual accounts Adjust CPI "Progressive Indexing"	Not picked up by Congress

2010 Simpson-Bowles Commission	Change benefit formula Increase retirement age Adjust CPI	Commission recommendations not picked up by President or Congress

Although afforded less publicity in debates over the American Relief and Recovery Act (ARRA) than tax cuts versus public works, or in debates over the Affordable Care Act than individual mandates and premium subsidies, the first two years of the Obama Administration saw two significant expansions of social insurance. In the first case, ARRA provided $7 billion in "Race to the Top"-style incentive money for states that reformed their Unemployment Insurance systems. States could gain ARRA money by adopting "Alternate Base Periods" that allow workers to claim eligibility for UI by counting their most recent earnings as opposed to the previous year's earnings, and agreeing to cover part-time workers who are looking for full-time work and workers who leave work due to family emergencies.

In the second case, the Affordable Care Act made some of the most significant changes in Medicare and Medicaid in decades. Medicare's finances were improved through the increase in Medicare taxes on the wealthy and the reduction of Medicare Advantage and provider payments, an attempt was made to contain costs by shifting Medicare payments from fee-for-service to performance-based lump sums, and benefits were improved by the closing of the Medicare Part D "donut hole." Medicaid was transformed by extending coverage to all Americans below 133% of poverty (at least before the Supreme Court made such extension optional), and increasing payment levels to those of Medicare.

However, after the 2010 midterm elections and even more so after the Supreme Court's decision in *NFIB v. Sebelius*, the Obama Administration has made few public defenses (let alone arguments for expansion) of social insurance, choosing instead to concentrate its efforts on protecting the individual mandate. As a result of this strategic choice, the one model of social policy least defended or advocated for is ironically the most historically successful model for providing health and economic security.

Conclusion

If history can offer any guide to public policy experts or to the electorate at large, at the very least it can tell us whether we've tried public policies in the past and how well they've worked so that informed decisions for the future can be made on more than theoretical grounds.

The verdict of history when it comes to these three models of social policy is quite clear: employer-based insurance and individual accounts have always been fatally flawed; the former is dying on its feet and the latter is simply not fit for purpose.

Unfortunately for those who love counter-intuitive "truth-telling," the reality is that social insurance is a historical success. It has been far more effective than either employer-based benefits or individual accounts, and future policy should reflect these lessons. Instead of making a limited and targeted defense of middle class social protections from privatization, we should be making a bold argument for the expansion of social insurance to meet the rising tide of insecurity, inequality, and poverty in America.

Endnotes

[1] Friendly societies were dues-based mutual aid or welfare funds operated by craft unions, ethnic associations, and fraternal orders like the Masons.

[2] Colin Gordon, *New Deals: Business, Labor, and Politics in America, 1920-1935,* (Cambridge University Press, 1994), 12.

[3] Sanford Jacoby, *Modern Manors: Welfare Capitalism Since the New Deal*, (Princeton University Press, 1998), p. 13.
[4] Ibid, p. 13-32.

[5] Ibid.

[6] Jennifer Klein, *For All These Rights: Business, Labor, and the Shaping of America's Public-Private Welfare State,* (Princeton University Press, 2006), 63.

[7] Jacoby, *Modern Manors*.

[8] Klein, *For All These Rights*.

[9] Liz Cohen, *Making a New Deal* (Cambridge University Press, 1990) p. 65-69; Jenn Klein, p. 56.

[10] Klein, "The Politics of Economic Security: Employee Benefits and the Privatization of New Deal Liberalism," *The Journal of Policy History*: vol. 16, no. 1 (2004), 47.

[11] Ibid.

[12] Jacob Hacker, *The Divided Welfare State*, (Cambridge University Press: 2002), p. 85, 93.

[13] Ibid.

[14] Ibid, p. 89.

[15] Klein.

[16] "National Compensation Survey: Employee Benefits in the United States," John Schmitt and Janelle Jones, "Where Have All the Good Jobs Gone?" Center for Economic and Policy Research, 2012; Alicia H. Munnell, Jean-Pierre Aubry, and Dan Muldoon, "The Financial Crisis and Private Defined Benefit Plans," Center for Retirement Research at Boston College, Number 8-18.

[17]Jeanette Wicks-Lim, "Creating Decent Jobs in the United States: The Role of Labor Unions and Collective Bargaining," Political Economy Research Institute, University of Massachusetts, Amherst, September 2009, Table 8.

[18] Teresa Ghilarducci, Robert Hiltonsmith, and Lauren Schmitz, "State Guaranteed Retirement Accounts: A Low-Cost, Secure Solution to America's Retirement Crisis," Demos, November, 2012.

[19] Eric Laursen, *The People's Pension: The Struggle to Defend Social Security Since Reagan*, (AK Press: 2012), Chapter 14.

[20] Ibid, Chapter 13.

[21] Ibid, Chapters 38-39.

[22] Steve Idemoto, "Social Security Privatization in Chile: A Case for Caution," Economic Opportunity Institute, September 2000.

[23] Idemoto, "Social Security Privatization in Chile."

[24] Larry Rohter, "Chile's Retirees Find Shortfall in Private Plan," *New York Times*, January 27, 2005.

[25] Mitchell Orenstein, "Pension Privatization in Crisis: Death or Rebirth of a Global Policy Trend?" *International Social Security Review*, Vol. 64, 2011.

[26] Norma Cohen, "A Bloody Mess," *The American Prospect*, January 14, 2005; "Pension Privatization in Britain: A Boon to the Finance Industry, a Boondoggle to Workers," Economic Opportunity Institute, September 2000.

[27] Peter Orszag, "Administrative Costs in Individual Accounts in the United Kingdom," Center on Budget and Policy Priorities, March 1999.

[28] "Pension Privatization in Britain: A Boon to the Finance Industry, a Boondoggle to Workers."

[29] Laursen, 516-517.

[30] John Dicken, "Health Savings Accounts: Participation Increased and Was More Common Among Individuals with Higher Incomes," Government Accountability Office, Letter to Henry Waxman and Pete Stark, House of Representatives, April 1, 2008.

[31] Teresa Ghilarducci, "Our Ridiculous Approach to Retirement," *New York Times*, July 21, 2012.

[32] Lukas Pleva, "Texas Congresswoman Eddie Bernice Johnson says Social Security slashed poverty among the elderly," PolitiFact; National Bureau of Economic Research, "Social Security and Elderly Poverty."

[33] John Karl Scholz, Robert Moffitt, and Benjamin Cowan, "Trends in income support," Institute for Research on Poverty, University of Wisconsin-Madison.

[34] U.S Census Bureau, *Income, Poverty, and Health Insurance Coverage in the United States*, p. 23.

About the Project

The Next Social Contract Initiative *aims to rethink our inherited social contract, the system of institutions and policies designed to empower and support citizens from childhood through work and retirement. Inspired by the premise that economic security and opportunity are mutually reinforcing, a new social contract should foster innovation and openness, encourage long-term growth and broadly shared prosperity, and engage individuals and families not only as participants in the economy but also as citizens.*

About the Series

Renewing the American Social Contract *is a series of major policy papers outlining bold proposals from leading thinkers for reforming American social policy in areas from wages and job creation to taxation and the welfare state. Representing diverse perspectives from across the political spectrum, the contributors to the series share a commitment to questioning orthodoxy and enlarging the boundaries of debate.*

The Next Social Contract Initiative is made possible with support from the Rockefeller Foundation.

© 2012 New America Foundation

This report carries a Creative Commons license, which permits re-use of New America content when proper attribution is provided. This means you are free to copy, display and distribute New America's work, or include our content in derivative works, under the following conditions:

Attribution. You must clearly attribute the work to the New America Foundation, and provide a link back to www.Newamerica.net.
Noncommercial. You may not use this work for commercial purposes without explicit prior permission from New America.
Share Alike. If you alter, transform, or build upon this work, you may distribute the resulting work only under a license identical to this one.

For the full legal code of this Creative Commons license, please visit www.creativecommons.org. If you have any questions about citing or reusing New America content, please contact us.

1899 L Street, NW
Suite 400
Washington, DC 20036
Phone 202 986 2700
Fax 202 986 3696

NEW AMERICA FOUNDATION

WWW.NEWAMERICA.NET