UNION WORKERS SHOULD SUPPORT SOCIAL SECURITY PRIVATIZATION

by Michael Tanner

Executive Summary

Union leaders have been among the most vocal opponents of privatizing Social Security. Their opposition is something of a mystery, because union workers would be among those who would gain the most if Social Security were transformed to a system of individually owned, privately invested accounts. Because a privatized Social Security system would provide a higher rate of return, union workers would receive far greater benefits than they would under the current Social Security system. In contrast, traditional Social Security fixes, such as raising payroll taxes, would severely harm union workers. Perhaps more important, privatizing Social Security would break down traditional barriers between labor and capital by giving workers a greater opportunity to own wealth-producing investments. In effect, every laborer would become a capitalist.

UNION WORKERS SHOULD SUPPORT SOCIAL SECURITY PRIVATIZATION

by Michael Tanner

Introduction

Union leaders have been among the most vocal opponents of privatizing Social Security. Their opposition is something of a mystery, because union workers would be among those who would gain the most if Social security were transformed to a system of individually owned, privately invested accounts.

The irony is that union bosses have become the last die-hard defenders of Social Security, because unions were among the program's original opponents. In fact, Samuel Gompers, the father of the American labor movement, called the concept of government-provided social insurance, "in its essence undemocratic."[1] More important, by opposing privatization and supporting such traditional Social Security fixes as tax increases and benefit cuts, union leaders are sacrificing the best interests of American workers.

A privatized Social Security system, in which workers are allowed to divert their payroll taxes to individually owned, privately invested accounts, similar to individual retirement accounts (IRA) or 401(k) plans, would provide workers with better and more secur retirement benefits, would give them a greater voice in corporate management and a sense of ownership and participation in the American economy, and would avoid painful tax hikes or an increase in the retirement age.

Better Retirement Benefits

The average union worker earns approximately $33,200 a year.[2] If that worker is 35 years old, upon retirement at age 67, Social Security promises to pay the worker $1,559 a month. That, however, is only a promise. Social Security currently cannot pay for between one-quarter and one-third of the benefits that have been promised. Nevertheless, assuming that the worker receives everything that is prom-

---

Michael Tanner is director of health and welfare studies at the Cato Institute and the director of the Institute's Project on Social Security Privatization.

ised, $1,559 a month is not very much to live on in retirement. Yet it may be all that the retiree has.

Typical workers, who earn an average of $33,200 a year during their working years, will receive approximately 70 percent of their retirement income from Social Security.[3] By contrast, if the same workers were able to invest their Social Security taxes in bonds, a virtually risk-free investment, at retirement they would have accumulated enough money to purchase annuities paying $2,671 a month. If they invested in a balanced portfolio, divided equally between stocks and bonds, they could purchase annuities of $5,002 a month. And if they invested it all in stocks, they would be able to purchase annuities paying an astounding $9,575 a month.[4]

Or workers might choose to make programmed withdrawals from the accumulations in their accounts (more than $400,000 from a bond fund, more than $1.1 million from a stock fund). In that case, if a worker died before exhausting the account funds, the worker's heirs would receive all of the remaining money.

No matter which investment or retirement strategy was chosen, both the workers and their families would be at a greater advantage in the private system.

Breaking Barriers between Capital and Labor

An important side benefit of Social Security privatization is that it would give working Americans an opportunity to participate in the American economy by owning a part of it. In effect, privatizing Social Security would act as a nationwide employee stock option plan that would enable even the poorest workers to become capitalists. Through Social Security privatization, workers would become stockholders. The artificial and destructive division between labor and capital would be broken down.

Americas have more economic and social mobility than do the people of almost any other nation; Americans move both up and down the social and economic ladder. Most people who are poor today are unlikely to be poor 10 years from now.[5] However, when it comes to the accumulation of wealth, workers are at a distinct disadvantage. For example, the bottom 50 percent of American income earners own just 2 percent of the nation's financial wealth. The top 1 percent owns more than 56 percent of all net financial assets. The financial wealth of the top 10 percent is 4,653 times greater than the financial wealth of the bottom 20 percent.[6]

One of the main reasons for that disparity is that many workers are unable to take the surest route to wealth creation--savings and investment. Approximately one-third of all income in America comes, not from wages, but from savings and investment.[7] As Louis Kelso, father of the employee stock ownership plan, noted, "The bulk of wealth is produced, not by human labor as under pre-industrial conditions, but by capital instruments. . . . Capital and not labor is the source of affluence in an industrial society."[8]

But most union workers do not have the financial resources to save and invest. Clearly, imposing the Social Security tax on workers reduces their private savings. Workers are required by law to pay Social Security taxes. That requirement precludes their investing their wages in private savings or investments.[9] The payroll tax is the largest tax most union workers pay. Indeed, nearly 76 percent of Americans pay more in Social Security taxes than they do in federal income taxes.[10]

The average union worker, earning $33,200 a year, will pay $4,117 a year in Social Security taxes (including the employer share). That leaves very little money to invest privately. The inability to invest is borne out by the low participation rates of low-income workers in company-sponsored 401(k) plans. Only 64 percent of low-wage workers contribute to the 401(k) plans offered by their employers, compared with more than 90 percent of their higher wage colleagues.[11] Low-wage workers who do participate contribute an average of only 4.73 percent of their wages, compared with an average of 6.79 percent for high-wage workers.[12]

Low-income workers are also less likely to work for companies with private pension plans. For example, small businesses and service-sector employers are far less likely to offer pensions and other retirement benefits than are large corporations.[13]

Finally, Social Security may be contributing to the wealth gap even more by reducing the value of wages and increasing the value of capital. Because Social Security reduces savings and capital accumulation, it reduces the ratio of capital to workers, which means that each worker will be less productive, on average. As a result, wages are lower than they would be otherwise. At the same time, with less capital available, the return on capital may be higher than it otherwise would be.[14]

Privatizing Social Security would enable low-wage workers to participate in the wealth-creating mechanisms of saving and investment. If they had the opportunity to save and invest 12.4 percent of their income--the amount now taken by Social Security--low-wage workers would be able to accumulate substantial nest eggs.

That sort of worker empowerment and opportunity for the poor has brought many liberal Democrats to support the privatization of Social Security. As Sen. Robert Kerrey (D-Neb.) has pointed out, privatizing Social Security is as much about "generating wealth" as it is about the system's financing. Kerrey says that "every American [should have] a chance to own part of his country."[15]

Sam Beard, a former aide to Sen. Robert Kennedy (D-Mass.), calls this process the "democratization of capital" and points out that privatizing Social Security will give every American a real stake in our economic future. Beard also notes that the benefits are psychological as well as tangible, emphasizing that "personal participation will make savings and economic education part of everyone's day-to-day experience. . . . The benefits of this knowledge for individuals and families will include increased economic capability, a confident sense of the future, and more power to make fundamental choices that effect their lives."[16]

As a result of the enormous accumulation of wealth by the working class through their retirement accounts, the socialist dream of workers' owning the nation's businesses and industries would be effectively achieved. Since workers would own shares in the companies they worked for, they could have a greater voice in corporate governance and management decisions.

Overall, the distribution of wealth in the United States would likely be more equal than it is today. The change in distribution would occur, not through the counter-productive and illegitimate redistribution of existing wealth, but through the creation of new wealth in workers' retirement accounts. In fact, Harvard economist Martin Feldstein has estimated that if Social Security were privatized, the concentration of wealth in America would be reduced by half.[17]

As the division between labor and capital dissolved as the nation's workers became capitalists, the social and political effects would be sharply increased support for free-market economic policies. Since workers would own part of the nation's businesses, they would become more skeptical of unnecessary tax burdens and regulatory market interference that harm business performance. Since workers would own much of the nation's capital, they would oppose harsh multiple taxation of capital gains. General strife and antagonism between labor and management could be replaced by cooperation, since workers would benefit directly from the general prosperity of companies in which they shared ownership. As Alan Greenspan has explained, "[If workers] knew what they owned in their retirement programs as distinct from having a generic overall type of program, there [is] a considerable amount of pride in that, and it has a very important effect on people's citizenship in society."[18]

Alternatives to Privatization Would Hurt Union Workers

Social Security is facing a severe financial shortfall. In fact, by 2013 Social Security will begin to run a deficit--spending more on benefits than it collects in taxes.[19] In the absence of privatization, Social Security will be forced to raise taxes or cut benefits, options that would be very painful for union members.

Social Security has already raised payroll taxes 38 times since the program began, with serious consequences for workers. According to the Congressional Budget Office, payroll tax increases between 1979 and 1982, for example, resulted in the permanent loss of 500,000 jobs.[20] A study of the 1988 and 1990 payroll tax hikes, by economists Gary Robbins and Aldona Robbins, estimated permanent job losses at approximately 510,000 and a reduction of the U.S. gross national product of $30 billion per year by the year 2000.[21]

Also important is the fact that the payroll tax is an extremely regressive tax. First, it is a tax on wages, leaving other income sources, such as capital gains, interest, and other profits on investment, untaxed. Second, because the amount of income subject to the tax is capped, low-income workers pay a higher percentage of their income in Social Security taxes than do high-income workers. As a result, the payroll tax is a tax aimed directly at union workers.

Benefit cutbacks would also disproportionately affect union workers. For example, delaying retirement imposes only a modest burden on many white-collar workers and managers, but can mean substantial hardship for many blue-collar workers and manual laborers. Surveys have consistentlyshown that white-collar workers are more likely to enjoy their work and are more willing to work beyond age 65.

Therefore, by opposing privatization, union leaders may be forcing Social Security reforms that will leave their members at a great disadvantage.

Conclusion

Union workers would be among the people who would benefit most from the privatization of Social Security. They would receive far better retirement benefits under a privatized system, would achieve greater participation in the economy, would have the opportunity to accumulate real wealth, and would avoid painful tax hikes or benefit cuts. Union leaders should abandon their ideological attachment to Social Security and do what is best for their members--support Social Security privatization.

Notes

1. Samuel Gompers, "Not Even Compulsory Benevolence Will Do," American Federationist 24 (January 1917): 48.

2. Bureau of Labor Statistics, "Union Members Summary," Developments in Labor Management Relations, January 30, 1998.

3. Niel Gilbert and Neung-Hoo Park, "Privatization, Provision, and Targeting: Trends and Policy Implications in the United States," International Social Security Review 49 (January 1996): 22.

4. Calculations assume a 4 percent rate of return on bonds and a 7 percent rate of return on stocks.

5. See, for example, Richard Burkhauser, Douglas Holtz-Eakin, and Stephin Rhody, "Labor Earnings Mobility and Inequality in the United States and Germany in the Growth Years of the 1980's," accepted for publication in International Economic Review; and W. Michael Cox and Richard Alm, "By Our Own Bootstraps: Economic Opportunity and the Dynamics of Income Distribution," Federal Reserve Bank of Dallas, 1995.

6. James Smith, "Unequal Wealth and Incentives to Save," RAND Corporation, Santa Monica, California, 1995.

7. "Remodeling Social Security," Economic Security 2000, Washington, 1997.

8. Quoted in Sam Beard, Restoring Hope in America: The Social Security Solution (San Francisco: Institute for Contemporary Studies, 1996), p. 160.

9. Many economists also argue that Social Security benefits reduce savings. Since Social Security provides beneficiaries with retirement income, people think they have less need to personally save for retirement. Martin Feldstein, "Social Security, Induced Retirement, and Aggregate Capital Accumulation," Journal of Political Economy 82, no. 5 (September-October 1974): 825-62; Martin Feldstein, "Inflation, Tax Rules and Investment: Some Econometric Evidence," Econometrica 50, no. 4 (July 1982): 825-62; and Peter Diamond and J. A. Hausman, "Individual Retirement and Savings Behavior," Journal of Public Economics 23, nos. 1-2 (February-March 1984): 81-114.

10. U.S. House of Representatives, Committee on ways and Means, Background Materials on the Federal Budget and Tax Policy for the Fiscal year 1991 and Beyond, Committee Print, February 6, 1990, p. 30.

11. Peter Elinsky and James Buckley, "Retirement Benefits in the 1990's: 1997 Survey Data," KPMG Peat Marwick, 1997, p. 32.

12. Ibid., p. 34.

13. Ibid., pp. 28-31.

14. Martin Feldstein, "Social Insurance," Harvard Institute of Economic Research Discussion Paper no. 477, May 1976.

15. Robert Kerrey, Speech to the National Press Club, Washington, September 17, 1997.

16. Beard, p. 143.

17. Martin Feldstein, "Social Security and the Distribution of Wealth," Journal of the American Statistical Association, December 1976, pp. 90-93.

18. Alan Greenspan, Testimony before the House Budget Committee, October 8, 1997.

19. Under intermediate assumptions. See _1998 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds_ (Washington: Government Printing Office, 1998), pp. 28-30.

20. Congressional Budget Office, "Aggregate Income Effects of Changes in Social Security Taxes," August 1982, p. 30.

21. Gary Robbins and Aldona Robbins, "Effects of the 1988 and 1990 Social Security Tax Increases," Institute for Research on the Effects of Taxation, Washington, 1991, pp. 14-15.