401(k)s are retirement robbery: How the Koch brothers, Wall Street and politicians conspire to drain Social Security

The decades-long tale of how the Kochs, Reagan, Wall Street and even Democrats have tried to gut Social Security

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On the eve of the Reagan presidency in 1980, Milton and Rose Friedman published "Free to Choose," a proposal for gradually phasing out Social Security. The entitlements of retirees would be honored as would the accumulated credits of contributors who had not yet retired. But no new payroll taxes would be collected. The final elimination of Social Security would allow "individuals to provide for their own retirement as they wish." Among the advantages would be that "it would add to personal saving and so lead to a higher rate of capital formation [and] stimulate the development and expansion of private pension plans." While the Friedmans argued for such a plan, they acknowledged that immediate privatization of retirement was unrealistic in the current political climate, but they would accept incremental reforms with the hope that one day total privatization would become politically feasible.

That same year, the conservative Koch brothers-financed Cato Institute published "Social Security: The Inherent Contradiction," by Peter Ferrara, which argued that instead of being required to participate in Social Security, people should "be allowed to choose from a variety of insurance and investment options offered in the private market. The previous year, two years after its founding in 1977, the institute had published an article by Carolyn Weaver in which she made the case for privatization, and in 1980 it also sponsored a conference on Social Security privatization that drew, among others, two hundred congressional staffers.

When Ronald Reagan came into office in 1981, Social Security was facing a shortfall in revenue necessary to meet expenses. Reforms of some type were necessary. Privatization, while undoubtedly attractive to Reagan and his inner circle, was not politically feasible. It was a new idea that still had not gained traction in the governing class, and the United States was not Chile, with a military dictatorship that could impose it by fiat. Social Security would have to be reformed by raising taxes or lowering benefits, or some combination of the two to bring its budget back into balance. Increasing the then contribution rate of 5.35 percent would be a tax

rise that was anathema to Reagan‘s conservative principles. Instead, there would have to be benefit reductions.

Reagan had appointed David A. Stockman, an advocate of neoliberal economics, as his director of the Office of Management and Budget and charged him with reducing welfare entitlements. Stockman soon turned to the problem of Social Security, which he described as “one giant Ponzi scheme.” What particularly bothered him was its intentionally redistributional feature wherein lower-income groups received greater returns on their contributions than higher- income ones to keep them out of poverty. This he saw as “closet socialism,” an unearned welfare benefit. His planned cuts were announced in May 1981. The main cut reduced benefits of those who retired early at age sixty-two before their age of full retirement at sixty-five. Their benefits would be slashed from 80 percent to 55 percent of full retirement age benefits. Negative reaction was immediate from senior groups, labor unions, and politicians. The Senate passed a 96–to-0 motion in opposition.

Facing such a firestorm of opposition, the Reagan administration retreated and regrouped. It then chose a different and less confrontational course of action. In 1983, the president named a commission with Alan Greenspan at its head to devise internal reforms for Social Security financing. As a result of Greenspan Commission recommendations, reforms were made to both increase revenues and decrease benefits—the first benefit decreases in the history of Social Security. It was a compromise. Reagan had to accept a tax increase that would rise to 6.2 percent that he did not want. Supporters of Social Security had to accept benefit cuts that they did not want.

The main reduction of benefits came from a gradual increase in the normal retirement age from sixty-five at the inception of the program in 1935 to sixty-seven for workers born after 1960. The more that retirement was delayed, the less that the fund would have to pay out in benefits.

Social Security benefits had not previously been taxed, but beginning in 1984, they would be partially taxed. The reform established two income thresholds that would be adjusted according to inflation and other causes. Recipients whose combined income from all sources falls below the first threshold do not have any of their Social Security income subject to taxes. Those between that and the top threshold have 50 percent of Social Security benefits counted as income for tax purposes, while those above the top threshold have 85 percent counted. Taxation of benefit income increases Social Security revenues because it is kept within the program, though it decreases benefit amounts for those subject to it.

Additionally, the Windfall Elimination Provision (WEP), also implemented in 1984, reduced the benefits of individuals with long periods of uncovered employment. Social Security officials had noticed in benefit calculations that such individuals appeared to be poorer than they really were and therefore eligible for higher income replacement amounts. Social Security was in part designed as an elderly poverty prevention program. The poor receive higher income replacements than those with higher incomes. If a person had twenty years of covered and thirty years of uncovered employment, the thirty years of zero contributions were treated as thirty years of zero income. That pulled down the overall income average to below poverty levels, making them eligible for higher benefit amounts than they otherwise would have been.

The WEP eliminated the extra income. But it did it in an awkward manner that caused hardship for those subject to it. In its annual statement of estimated benefits, Social Security does not take into account any possible impact of the WEP. It only states that there could be an impact on some individuals. That leads individuals subject to the provision to believe that their benefits will be higher than they actually will be.

A Leninist strategy

Privatization advocates were not happy that the system was only being internally reformed and never abandoned their long-range goal. In 1984, the year that the Greenspan reforms began, Stuart Butler and Peter Germanis from the Heritage Foundation wrote "Achieving a'Leninist' Strategy," a plan for waging "guerrilla warfare against the Social Security System and the coalition that supports it," which was published in the Cato Journal. Their nod to Vladimir Lenin, the architect of the Bolshevik Revolution, who is not normally approvingly cited in conservative literature, was based on an analogy. In the authors' understanding, Lenin viewed capitalism as an unstable system that would eventually collapse because of its inherent contradictions. To speed up the collapse, it was necessary to mobilize workers and others who would gain from the future socialist society. Butler and Germanis, as free market conservatives, did not agree that capitalism was doomed to collapse from its internal contradictions or that workers would be better served under socialism. They believed that it was Social Security by way of analogy that was doomed because of its contradictions, and its collapse could be speeded up through political organizing. What they were really interested in borrowing from Lenin was his shrewd organizing skill. Lenin understood, according to Butler and Germanis, "that fundamental change is contingent both upon a movement's ability to create a focused political coalition and upon its success in isolating and weakening its opponents." The key was to divide the coalition in favor of maintaining Social Security while mobilizing a coalition that would supposedly gain from private accounts. The first step would be to neutralize opposition to privatization from present beneficiaries by assuring them that their benefits would be maintained—a tactic employed in many occupational benefit conversions to less favorable plans. The reform would only affect younger workers, who needed to be educated about the problems of Social Security and how they would be supposedly better served by private accounts. "An economic education campaign . . . must be undertaken to demonstrate the weaknesses of the existing system and to allow it to be compared accurately (and therefore unfavorably) with the private alternative." Who should carry out this "education" campaign? None other than the main beneficiaries of privatization, who Butler and Germanis unabashedly identified as "the banks, insurance companies, and other institutions that will gain from providing such plans to the public."

It's not difficult to see why Butler and Germanis thought that the financial services industry would be interested in Social Security privatization. Thirty-five percent of total retirement contributions in the United States are made to Social Security, which puts them beyond the reach of the private market. The more that Social Security can be privatized, the more new profit opportunities the financial services industry will have. If it cannot be privatized immediately, the more that its benefits can be reduced, the more that people will have to resort to private accounts for their retirement provision. That economic interest is completely consistent with the conservative think tanks' traditional promotion of the free enterprise system. The current Cato

Handbook for Policymakers lists as a key talking point that workers would do significantly better with private accounts than Social Security.

Social Security taxes are already so high, relative to benefits, that Social Security has quite simply become a bad deal for younger workers, providing a low, below- market rate of return. This poor rate of return means that many young workers' retirement benefits are far lower than if they had been able to invest those funds privately. However, a system of individual accounts, based on private capital investment, would provide most workers with significantly higher returns. Those higher returns would translate into higher retirement benefits, leading to a more secure retirement for millions of seniors.

That claim is consistent with the "Leninist" strategy first announced thirty years ago: assure those in or near retirement that their benefits won't change, while convincing younger workers that they would be better off in a new privatized system. After leaving office, George W. Bush continued to repeat the claim that private accounts would deliver better returns than Social Security. In his 2010 memoir, Decision Points, he stated, "Younger workers should have the option of earning a better return by investing part of their Social Security taxes in personal retirement accounts."

Comparison of Social Security and private plans

Is it true that private accounts deliver higher rates of return than Social Security? To test the claim, I started by comparing my Social Security statement with my TIAA-CREF statement. Both list the total contributions made by employers and me. The Social Security statement indicates my benefit at sixty-six, the age of my full retirement. My TIAA-CREF statement has the total accumulation. Since I was nearly sixty-six, I knew how much an annuity income it was worth. My first year Social Security benefit was 12.61 percent of my total contributions. The first-year TIAA annuity was 12.06 of total contributions—lower, not higher than the return on my Social Security contributions as the Cato Institute and President Bush so confidently claimed. Remember also that as a professional, I am in a relatively high-income category with a Social Security rate of return that is less than that of lower-income participants. For them, the rate of return for Social Security compared to private accounts would be much higher than mine, making it an even better deal. On top of that, Social Security contains disability insurance for all income groups, while private plans do not.

Former Secretary of the Treasury Lawrence Summers, despite his being associated with privatization plans, gave one reason why Social Security's rate of return compares favorably with private plans: "Social Security is effective, in large part because it is efficient. More than 99 cents are paid in benefits by Social Security for every dollar that is paid in by workers and employers. Few, if any, private systems—anywhere in the world—come close to matching this efficiency."

Like the optimistic projections of the financial services industry whose interests it serves, the Cato Institute's claim is based on before-the-fact, overly optimistic assumptions of future market returns. My comparison was based on after-the-fact, actual experience.

Butler and Germanis, in their strategy of undermining public support, had called for requiring Social Security to send annual statements of accounts to participants. Individuals could then compare their returns from private investment with their returns under Social Security. Younger workers would see just how much of a loss they are supposedly taking by participating in the program. This mechanism for demonstrating the individual gains and losses that occur under Social Security would be a key step in weakening public support for the present system.

A push for privatization

In 1989, New York Senator Daniel Patrick Moynihan, a supporter of private accounts, sponsored an amendment to the Social Security Act to require that such statements be sent to participants—the origin of the current Social Security statement that began in 1995. If the motive behind the legislation was to promote support for private accounts over Social Security, it has backfired, as the statements have helped people to realize the value of the program, especially during stock market declines.

Through the end of the 1980s, the campaign for Social Security privatization remained ideological. The financial services industry was content with its burgeoning 401(k) business, and there were no serious legislative proposals on the table. The trust fund itself, following the 1984 revenue increases, had a growing surplus, but that didn't stop the conservative think tanks from attempting to undermine public confidence in it.

The 1994 publication of the World Bank's Averting the Old Age Crisis lent needed legitimacy to the privatization crusade to move it into mainstream political support. The implication of the bank's privatization manifesto was that most of Social Security should be replaced by mandatory private accounts, leaving only a small part of the original system to mitigate elderly poverty. That same year, a Social Security advisory commission released a report that included the recommendations of privatization advocates.

The privatization campaign regained traction. Republicans, as always, were warm to privatization proposals, but now with World Bank approval, so-called "New" and "Third Way" Democrats that included President Bill Clinton joined the campaign. Prominent Democrats who favored some form of privatization included Summers; Jeffrey Sachs, a major adviser on the Russian privatization reforms; Bob Kerrey, a senator from Nebraska; and Joseph Lieberman, a senator from Connecticut who was the party's 2000 vice presidential candidate.

This was the first fissure in the Democratic Party's traditional stalwart defense of Social Security, the crown jewel of New Deal social programs. The fissure revealed the growing momentum of the privatization coalition; the idea had moved from the ideological sidelines to embrace by the financial services industry as a new goal. The financial services industry, through its campaign contributions and lobbyists, had influence within the Democratic as well Republican parties. A fifth column had opened up among the party's elites. The Democrat privatizers, though, had even greater political problems than the Republican ones. They didn't have to just worry about passing an unpopular proposal over widespread public opposition. Unlike the Republicans, they also had to deal with widespread objections from their own party's base, especially labor unions, and other members of their elite as well. Clinton's support, though,

of NAFTA and welfare reform had indicated that he was willing to defy the opposition of his party‘s base when he thought it was necessary because of economic pressure from elites, as in the case of NAFTA, or political expediency, as in the case of welfare reform.

From the ideological sidelines, Friedman continued to urge privatization. Meanwhile, the Cato Institute offered as its expert to head a Social Security privatization project none other than José Piñera, the former minister of labor of the Pinochet dictatorship who was responsible for completely privatizing Chile‘s national retirement system. After the return of democracy, Piñera had run for president in 1993. The Chilean people rewarded him for his service to the dictatorship with 6 percent of the vote. He then moved to Washington to continue his privatization mission from the more hospitable corridors of the Cato Institute. Piñera has had his eyes on more than US Social Security since leaving Chile. He has been on a mission to promote pension privatization throughout the world, following the model he designed and implemented in Chile. There is probably no single name as attached to its promotion as his. He claims that he lives on airplanes in an endless quest to spread the gospel of pension privatization. His website contains a color-coded international map titled “Atlas Freed,” after conservative icon Ayn Rand‘s best-selling novel “Atlas Shrugged.” The map purports to show in red the spread of the Chilean privatization model that he inaugurated, reminiscent in an obverse way of 1950s Cold War maps that showed the spread of the red tide of communism.

By the end of the 1990s, the most prominent conservative think tanks—Heritage, American Enterprise Institute, Cato, Manhattan— were often considered to be mainstream noncontroversial sources of information for newspaper and television reports about retirement issues. A 1998 Fairness and Accuracy in Reporting study found that conservative think tanks were often cited in media stories without identifying them as conservative. On the other hand, when liberal think tanks were cited, they were more often labeled as left or left leaning, making their findings ideologically suspect.

As of 1998, prospects for some form of Social Security privatization with Bill Clinton at the helm looked promising. Reportedly, a secret White House group worked on a partial privatization proposal for eighteen months. But after the Monica Lewinsky scandal exploded, the president backed away from launching any new initiatives that were likely to meet widespread public opposition. After the turnabout, historian Robin Blackburn wrote the wryly titled “How Monica Lewinsky Saved Social Security.”

What emerged instead was a rhetorical campaign to put what was then a growing federal revenue surplus into a “lock box” to “Save Social Security First.” Appended to the proposal was a provision to create USA accounts in which citizens could contribute up to $1,000 a year with an equal federal match into private accounts.

In the 2000 presidential election campaign, Republican and Democratic candidates George W. Bush and Al Gore presented different “carve-out” and “add-on” partial privatization proposals for Social Security. A carve-out would divert existing revenue into private accounts. An add-on proposal, like the USA accounts, would continue the same revenue base for Social Security, while giving citizens government subsidies to open private accounts in addition.

Carve-outs create tremendous transition costs for pay-as-you-go systems since revenue streams are reduced, while obligations are still in force. Add-ons avoid that problem but choke off the possibility of expanding the defined benefit character of Social Security. They represent a virtual commitment to all future government involvement in retirement provision on a defined contribution basis that subsidizes private accounts.

During his first term in office, President Bush laid the groundwork for partial privatization. His appointed disingenuously titled Commission to Strengthen Social Security issued its report in December 2001: "Strengthening Social Security and Creating Personal Wealth for All Americans." After winning reelection in 2004, the carve-out privatization proposal in the report became his top domestic priority. In January 2005, Karl Rove and Ken Mehlman designed a campaign to win public support for the reform. Two weeks later in the State of the Union address, the president announced his proposal, stating that Social Security was in crisis.

Under the plan, which would have been voluntary, individuals would have been able to divert 4 percent of the 12.4 percent Social Security payroll tax up to a limit of $1,000 a year to private individual accounts. That would have resulted in a carve-out and diversion of about 16 percent of Social Security revenues. Although the president insinuated that benefits would increase under the proposal, according to a Congressional Budget Office analysis, those opting for the individual accounts would suffer significant losses. Wage replacement rates for low- income workers would drop from 70 to 44 percent, for middle-income workers from 40 to 22 percent, and for high-income workers from 23 to 13 percent. Diversion of 16 percent of revenues would also have created enormous transition costs for the new system that could have only been made up with benefits cuts, a bailout from other federal revenues, or some combination of the two.

Bush toured the country to sell the idea and garner public support, but it quickly became evident that people weren‘t buying. The more he tried to sell the proposal, the more opposed public opinion became. Between January and June 2005, the Gallup Poll indicated that opposition to the proposal had risen from 48 to 64 percent. A coalition of organizations opposed to the proposal, which included labor unions and organizations of retired people, mounted an impressive counter-campaign. In a rare show of unity, almost all Democratic members of Congress were opposed. By late summer, the president was forced to abandon the proposal.

The partial privatization campaign ran into strong public opposition because so much of the public tangibly benefits from Social Security. It covers 94 percent of the labor force and replaces a substantial amount of preretirement income for most participants, keeping much of the elderly population out of poverty. Without it, 45.2 percent of the elderly population would be in poverty compared to the actual rate of 9.7 percent. Social Security benefits keep over 13 million elderly people out of poverty That feature alone wins support from younger persons who benefit indirectly because the existence of Social Security spares them from financially supporting older relatives.

The origin of the description of Social Security as the third rail of American politics resides in the statistical fact that sixty-five and older voters have the highest participation rate in elections. In the 2006 midterm election, for example, 60.5 percent of sixty-five and older persons voted, much higher than the 54.3 percent of the next highest group, those from forty-five to sixty-four

years old. Put differently, those sixty-five and older made up 22.5 percent of the electorate, even though they are only 16.2 percent of the voting age population. Altogether, the forty-five and older population that includes the retired and those approaching retirement made up nearly two-thirds of voters.

A new benefit-reductions campaign

The Bush proposal was defeated despite being launched when the stock market was modestly recovering following the September 11, 2001, terrorist attacks. That would seem to have put the issue to rest, especially after the 2008 plunge in market and 401(k) values. Though chastened by the resounding political defeat of Bush‘s partial privatization proposal, the opponents of Social Security reluctantly regrouped around a plan B approach to reduce its benefits, as had occurred under the Reagan administration. This was in line with the World Bank campaign to reduce public pillars in overall retirement provision. In 2010, President Barack Obama, with Summers as his director of the National Economic Council, appointed a supposedly bipartisan National Commission of Fiscal Responsibility and Reform charged with developing proposals to reduce the national deficit. He loaded the commission with Social Security opponents.

By the end of the year, as expected, the chairpersons of the commission, Erskine Bowles, a Democrat, and Alan Simpson, a Republican, announced proposals that included broad cuts to Social Security benefits. Simpson had earlier revealed his views crudely when he described Social Security, in an e-mail to the executive director of the national Older Women‘s League, as "like a milk cow with 310 million tits."

Bowles and Simpson proposed raising the full retirement age to sixty-nine, up from the increase to sixty-seven established by the Greenspan Commission in 1984. The rationale was that improved health conditions have led people to live longer. The longer that people live in retirement, the more that has to be paid to them in benefits, placing pressure on the fund. Improved health conditions presumably also make workers capable of working longer.

The problem with this assumption, as with all attempts to fix unitary retirement ages, is that working capabilities vary among individuals according to their own states of health and the nature of their jobs. Mining and construction wear out workers faster than teaching and administration. According to one study, 27 percent of workers age fifty-eight or older perform physically demanding jobs that cause them to age faster than those with less physically demanding ones. Another 18 percent perform jobs in difficult working conditions that also place strains on their health. Not surprisingly, there is a general correlation between income and being spared from performing physically demanding, damaging jobs. The higher the income of workers and employees, the less likely they are to have physically demanding jobs. Social class, in other words, is involved in selecting whose working conditions allow them to work and live longer. Longevity, it follows, has not increased across the board for all income groups. It has increased most for high-income groups, with low-income groups showing little increase. According to a careful study of Social Security records, life expectancy increased for all babies born between 1912 and 1941. But it increased far more for those in the top half of the earnings distribution. For them, it increased by an average 6 years compared to 1.3 years for those in the bottom half. To delay when low-income groups, who also tend to have the most physically

demanding jobs, can retire is to make them disproportionately pay the cost of higher-income groups living longer.

Bowles and Simpson proposed reducing the annual cost-of-living adjustment (COLA). Reducing COLAs would squeeze elderly budgets when medical costs usually rise. In the same way that inflation erodes the buying power of those on fixed incomes over time, reducing COLAs would reduce buying power by increasing the gap between annual benefit and actual cost-of-living increases.

By far the most significant but least obvious proposal—one that was rarely mentioned in press accounts—was to change the formula for determining benefits. Bowles and Simpson proposed changing it so that benefits would be shifted from higher- to lower-income groups. On the surface, this would appear to be a progressive policy—and they used the word progressive intentionally in their proposal to at least rhetorically appeal for liberal support—but it was deceptive. The effect of the formula change would reduce the benefits of middle-class participants by as much as 36 percent, thereby undermining their politically critical support for the program. The long-term effect, if not a stated goal, would be to reduce Social Security to an elderly poverty-reduction program only, eventually possibly even a means-tested one. That would be consistent with the stated World Bank goal of reducing public pillars of retirement programs to financing only elderly poverty prevention. Such a program would require less funding because it would benefit fewer people than the current program. At the same time, cutting and eventually eliminating benefits for the non-poor would make the working and middle classes more dependent on 401(k)-type private accounts and thereby route more money through the financial services industry.

The Simpson-Bowles report failed to garner the fourteen votes necessary of its eighteen commission members to have it automatically taken up by Congress. Yet, within three weeks of that failure, President Obama agreed to a plan to temporarily reduce Social Security employee payroll taxes from 6.2 to 4.2 percent, the first contribution reduction or tax holiday ever in the history of the program. The purpose was to help stimulate the economy by increasing take-home pay. The shortfall in revenue was made up by other government funds. The danger was that the cut would become permanent if anti-tax sentiment continued, and that, given its shifting politics, Congress could not be relied on to keep making up the shortfall, especially if Social Security would compete with education and other needed programs for scarce funding. Failure to restore the full tax would weaken the stability of the program‘s financing. It would be a gift to its opponents, who could see it as a self-fulfilling prophecy that the program was not fiscally sustainable.

In early 2013, the full Social Security tax was restored with virtually no public opposition. But at the same time, President Obama announced his support for a proposal to reduce Social Security‘s COLA as called for by the Simpson-Bowles Commission. Instead of basing the size of each year‘s benefit rise on the consumer price index, it would be based on a reduced chained consumer price index. According to one estimate, the average recipient would lose $16,663 over a thirty-year period. The struggle over Social Security thus has shifted during the past twenty years. Privatization has been off the table since the massive public reaction against former President Bush‘s 2005 proposal. The goal of Social Security‘s opponents has shifted to lowering

its benefits, first along the comprehensive lines of the Simpson-Bowles Commission proposals and then, when those failed to be adopted, lowering its COLA. In both campaigns to lower its benefits, it was insinuated that Social Security was a cause of the federal government's long-term debt, which in turn was alleged to be undermining the health of the economy. The reality, though, is that Social Security is a separate account that does not contribute to the government's debt, and it holds a surplus.

A more serious but also flawed argument is that Social Security's expenditures in the long run will outpace its income and thus must be adjusted downward now to keep the program solvent and not lower future benefits even more. The assumption of a long-term imbalance is a debatable proposition. But even if it were true, there is a far easier and more effective way to address the problem than cutting benefits, which will be discussed in chapter 8: remove the cap on amounts of income as well as on types of income that are subject to Social Security taxation. There is, in short, no fiscally necessary reason to lower Social Security benefits. There are, however, political reasons. Significant elements of the Republican Party are ideologically opposed to Social Security and want to at least trim the size of the program. That makes Social Security reduction a bargaining chip in budget negotiations with Democrats. In addition, as mentioned, the Democratic Party contains its own fifth column of Social Security opponents who are more than willing to cooperate with Republicans on the issue.

Two days after President Obama signed the Social Security tax cut in 2010, the New York Times called for long-term cuts in Social Security. That call was an indicator that there is a consensus among even moderately liberal elites that the program be reduced. Elite consensus on reducing the scope of Social Security, though, is not shared by the rest of the country, including the base of the Republican Party. Numerous public opinion polls have demonstrated strong majority support for maintaining or expanding Social Security benefits. In this respect, the clash between elites and the rest of the public reproduces a similar clash over the 1994 NAFTA. It had strong elite support but strong public opposition. Politicians, as always, are caught between what key economic elites and the majority of voters want. Elites have enormous resources, including campaign contributions and lobbyists, at their disposal. Ordinary people are less organized and have only their individual votes. Elites are wealthy enough not to need Social Security benefits for their own retirement. They don't want Social Security to absorb a significant part of the nation's retirement savings because the bulk of their incomes comes from stock market gains. Diverting the retirement investments of ordinary people into stocks increases the values of those stocks and thereby their wealth and income.

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