FDR's Social Security Paradox

by Jim Powell, April 30, 2009

If Social Security is so wonderful, why were people forced to participate, why was it set up as a monopoly, and why did it dump ever-larger costs onto the backs of future generations?

There never was a popular demand for Social Security, even during the Great Depression. Few Americans were interested in the kind of government-run program that the German politician Otto von Bismarck had introduced in Europe. According to Social Security expert Carolyn Weaver, author of *The Crisis in Social Security,* in 1929 about 95 percent of senior citizens were self-supporting — an increasing number had private pension plans or annuities. Many seniors were helped out by family and friends.

Despite the shock of the Great Depression, private pension plans continued to perform well. "Industrial pension plans not only grew steadily," Weaver reports, "but also proved quite resilient, with certain features improving markedly.... The rate of failure for existing plans, moreover, was relatively modest. Of the systems operating in 1929, those that were discontinued, closed to new employees, or suspended by 1932 [a low point in the Depression] involved less than 3 percent of all covered employees." People lost pension coverage primarily because they lost their jobs — a consequence of misguided government policies that brought on the Great Depression and prolonged it.

By 1935, President Franklin Roosevelt embraced the German idea that there should be government-run "social insurance." That wasn't legitimate insurance, where participants have a contract, they pay premiums based on their life expectancy, the premiums are used to make productive investments that will cover the benefits, and the participants and their heirs have a property right to receive benefits that have been paid for. As the Supreme Court later affirmed in *Flemming v. Nestor* (1960), nobody has a contractual right to receive specific Social Security benefits — Congress can change benefit formulas at any time. Nobody has a right to pass on Social Security benefits to heirs, as is done routinely with private annuities, pensions, and life insurance.

Perhaps because Social Security promoters didn't have much confidence in it, they insisted that it must be compulsory. It was funded by collecting an excise tax on payrolls — initially, 1 percent from an employee and 1 percent from his employer. In fact, both portions of the Social Security tax came out of the employee's pocket, since they were part of total labor cost. Instead of going to an employee as additional wages, the "the employer's portion" went to the government.

There was considerable opposition to the proposed Social Security Act from both Democrats and Republicans. Sen. Bennett Clark of Montana proposed an amendment that would have enabled employers to opt out of Social Security if they had pension plans offering more generous benefits than Social Security. That would have meant freedom of choice for employers and employees alike, but advocates of Social Security were adamantly against freedom of choice.

Social Security promoters must have feared that private retirement plans would offer a better deal. Wisconsin's "progressive" Democratic senator, Robert M. LaFollette, fumed that the Clark amendment "would be inviting and encouraging competition with its own plan which ultimately would undermine and destroy it." Roosevelt threatened to veto the Social Security bill if it had the Clark amendment. Freedom of choice was eliminated during the House-House conference, and Roosevelt signed the Social Security law on August 14, 1935.

In case anyone doubted that Social Security was a monopoly, employers across America were required to display this notice: "Beginning January 1, 1937, your employer will be compelled by law to deduct a certain amount from your wages every payday. This is in compliance with the terms of the Social Security Act signed by President Franklin Delano Roosevelt. This is NOT a voluntary plan."

Originally, the idea was to have Social Security taxes accumulate in a fund from which at least some benefits would be paid. But incredibly, Social Security promoters were concerned that politicians would loot the fund. For instance, Abraham Epstein, who had led the lobbying effort for a government-run program, wrote in *Nation* magazine, "Experience everywhere indicates that politicians will hardly be able to keep their hands off such easy money."

Accordingly, in 1939 Roosevelt turned Social Security into a pay-as-you-go system where current taxpayers funded the benefits of current retirees, and nothing was set aside to help take care of current taxpayers when they retire.

Roosevelt knew what he was doing. Edwin E. Witte, a University of Wisconsin economist whom he appointed to develop the original Social Security plan, warned that Social Security created unfunded liabilities "upon which future generations will have to pay large amounts annually." Witte got that right — tens of trillions!

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