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Why Privatizing the Golden Years Wouldn't Work

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By: Michael A. McCarthy, Truthout / News Analysis

This is an historic moment. Republicans and Democrats are no longer at odds over whether to tackle Social Security. The main issue is how much to cut. The right, like Rep. Paul Ryan, wants to entirely gut it. Leading Republican presidential candidate Gov. Rick Perry is even calling it a "Ponzi scheme." And Herman Cain wants to privatize it like Pinochet did in Chile. But Democrats, too, are taking a few swings at the program. Obama himself has even targeted it.

For a moment, leave aside Social Security's financial outlook. That political debate is more rhetoric than reality. In fact, Social Security has been running surpluses for years and there is a good chance that we will never exhaust the so-called trust fund. But even if it does run out decades away from now, as some suggest, raising the wage base is a reasonable option to get funds flowing back in. American politics rarely reflect what is really going on.

Instead, what would be the consequences of cutting the program? What would the elderly do if it were reduced? Could occupational pensions substitute for our public system?

It's hard to point to another country to offer insight. In comparison to the other advanced democracies, the US is already the most reliant on occupational insurance programs. In 2005, expenditures on private social programs accounted for 10.1 percent of gross domestic product, far above the Organization for Economic Cooperation and Development (OECD) average of 2.9 percent.

This is also true of old-age security. According to the OECD, 45.1 percent of retirement income in the US derives from occupational pensions, well above the OECD average of 19.5 percent. This contrasts with the fact that relative public spending on retirement income in the US is low compared to other advanced democracies. To a large extent, old-age security is already privatized.

But Social Security remains significant. Sure, it never lived up to Roosevelt's promise. It has to be supplemented with other savings (personal or private pensions) for it to provide an livable earnings. And sure, retirement income is tied to lifetime earnings, which reproduces labor market inequality in retirement.

Nevertheless, the gross pre-retirement earnings replacement rate for the medium wage earner in the US is 42.3 percent. That's well below the OECD average of 60.6 percent, but is still a sizable portion of retirement income.

With this income gone, Americans (the ones with jobs, at least) would have to become more reliant on, and try to expand, firm-based retirement schemes. Occupational pensions would have to make up for a lot. Yet, the prospects look dismal.

A large portion of today's occupational pensions were won by unions - something little discussed by politicians pushing the private alternative. After WWII, unions struck for pension benefits, but came up against resistance. To break the stalemate, Truman intervened and appointed the Steel Industry Board to investigate the union's pension demands at the Inland Steel Company. That case then went to the National Labor Relations Board in 1948, where the board ruled that the company had to bargain over pensions. The decision was upheld, against business appeals, by the Supreme Court in 1949 (not quite the Roberts court of today). Organized labor expanded private pensions through collective bargaining as a result.

Is such an outcome as this unlikely today? First off, the American labor movement is badly bruised. Lately, unions make more concessions on pensions than gains. And seeing the opportunity, employers are pushing back against these schemes, not welcoming expansions. Second, part and parcel is the Democrats' increased unwillingness to intervene in support of unions. The most recent example we have is the Employee Free Choice Act which Obama supported in his bid for president, but has all but ignored since he was elected.

With this option off the table, maybe retirees could turn to defined-contribution plans instead? Known mainly as 401(k)s, but including things like IRAs, what are the prospects for these types of plans to fill the gap if public pensions are reduced?

Defined-contribution plans shift risk away from the employer and onto the employee. Unlike defined-benefit plans (most union-negotiated pension plans), the employer is not obligated to provide a base amount of retirement income. Instead, in defined-contribution plans, the employer and the employee agree on an amount that the employer is going to put into a retirement fund for the employee. It is then up to the employee to contribute and make wise investment decisions in order to help grow her savings. If the employee makes bad decisions ... oh well.

And defined-contribution plans don't tend to mix well with sluggish economies. Throughout 2008, as the financial crisis swelled, the private pension system in the US lost 26 percent of its value. Because consumer prices rose nearly 5 percent in the same period, American workers on average saw the purchasing power of their private savings contract by 40 percent. The inflation-adjusted value of Social Security benefits, however, remained largely unaffected by the crisis.

Those hit particularly hard were individuals near retirement with mature, private defined-contribution schemes. Since 2008, pensions have begun to regain value, but those entering retirement when the crisis hit lost a large portion of their savings. In a bear market, private pensions don't offer much hope.

The growing bipartisan consensus around stripping the US public pension system is occurring in a context of no viable alternatives. Markets simply will not replace lost retirement income with organized labor on the defensive, and in some cases, outright surrendering. Social Security cuts the elderly poverty rate from over 45 percent to 10 percent. Without it, the golden years would be much grayer.