Creating Competitive Markets

THE POLITICS OF REGULATORY REFORM

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The Politics of Risk Privatization in U.S. Social Policy

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When President George W. Bush was reelected in 2004, he declared that his signature policy goal would be to incorporate "private accounts"—or, as advocates soon insisted they be called, "personal accounts"—into America's popular retirement program, Social Security. The details of Bush's plans were hazy, but the aspiration was clear: to transform Social Security from a single program with benefits defined in law into something closer to a 401(k) plan, in which a large chunk of workers' Social Security taxes are invested in private investment accounts from which they (or their heirs) alone benefit.

A year later, President Bush's hazy plan was dead, and leaders of the Republican-controlled Congress were scrambling to distance themselves from it. Polls showed that Americans preferred the security of Social Security to a more individualized framework.[1] Social Security, it seemed, was still the "third rail of American Politics"—touch it and die. The American welfare state had survived yet another assault.

Although Social Security survived intact, other once-secure benefits were unraveling, largely outside the public eye—namely, the employment-based private benefits on which Americans so heavily rely.[2] Between 2000 and 2005, the number of Americans lacking health insurance climbed to more than 46.6 million, an increase due entirely to a fall in the proportion of Americans covered by employment-based health plans.[3] The number without coverage at some point over a two-year period was even higher: some 80 million, or 1 out of 3 non-elderly Americans (nearly all lived in working families, and almost two-thirds were uninsured for six months or longer).[4] Roughly half of the 1.5 million personal bankruptcies in the United States in 2001, according to one estimate, were caused in part by medical costs and crises.[5]

Families have not been the only ones facing bankruptcy. As President Bush called on the private sector to rescue Social Security, key corporations called on the public sector to rescue them from their mounting private benefit costs. The financial meltdown of companies like United, Delta, Delphi, Ford, and GM, and the decision of otherwise healthy companies like Verizon, IBM, and Motorola to phase out their traditional pensions, threw into the spotlight the growing precariousness not just of company health benefits but also of so-called defined-benefit pension plans that offer a guaranteed benefit in retirement. An entire structure of benefits constructed in a more stable business climate was under siege.

These two sets of events—the continuing political strength of America's largest social insurance program and the continuing erosion of its uniquely extensive system of private workplace benefits—form the backdrop for this chapter. The welfare state and the market are my twin subjects. A key contention of this chapter, however, is that the sharp line often drawn between the two is much fuzzier and more contested than commonly believed. Alongside the public social programs typically identified with U.S. social policy lies a massive system of *private* social benefits that are regulated and subsidized by the government. When these private benefits are included in tallies of social spending, U.S. after-tax expenditures are as high (as a share of the economy) as the spending of many European nations.[6] Yet these private benefits are distributed in distinct ways, and they have distinctively shaped the evolution of U.S. social policy since the 1970s.

The now conventional view of this evolution can be summed up in a single world: *resilience*. Even before President Bush's Social Security plan went down in flames, analysts by and large agreed that the welfare state was the toughest of nuts for conservatives to crack. Despite intense strain and cuts around the margins, according to this conventional account, existing social policy frameworks were essentially secure, anchored by their enduring popularity, their powerful constituencies, and their centrality within the postwar order.

This chapter tells a different story. Although most U.S. public social programs have indeed resisted radical retrenchment, the American social welfare framework has also offered increasingly less protection against the key economic risks that confront Americans. As a result of both large-scale social changes and the ground-level transformation of America's public-private system of social benefits, individuals and families now face many of the most potent threats to their income on their own, rather than with the help of collective intermediaries, such as employers and the government. The American welfare state has not been privatized. Economic risk increasingly has.

This momentous transformation has not occurred naturally. Sweeping changes in the economy and family have propelled it. Yet, political leaders could have responded to these forces by reinforcing the buffers that protect families from risk. Instead, critics of the welfare state have attempted to trim these buffers back, with considerable, and largely unrecognized, success.

Today, however, the movement to privatize risk is running headlong into a nasty reality: many economic risks cannot be effectively dealt with in the private market. Ironically, the future of U.S. social policy—and, indeed, of America's dynamic and flexible free market more generally—may hinge on the rediscovery and reformation of the government's special role in softening the sharp edges of a competitive market economy.

Dismantling the Welfare State?

The privatization agenda in social policy has four main priorities: (1) to scale back direct government action so as to encourage self-reliance and private provision; (2) to expand subsidies for private insurance, savings, and charitable activities; (3) to expand government contracting with voluntary organizations and for-profit service providers; and (4) to infuse into established programs vouchers and other mechanisms that allow (or require) recipients to opt out of these programs and obtain benefits from the private sector instead. None of these strategies eliminates the government's role. Rather, they shift the emphasis from direct state action to private action under the management and oversight of government.

After two decades of debate, judgments still differ on how far the privatization agenda has progressed. In most rich nations, it is fair to say that the agenda itself never had much backing. But even where the ideology of privatization gained committed support, notably in Britain and the United States, achievements unquestionably fell short of ambitions. Some cutbacks have occurred. Some programs have been eliminated. But if the question is whether major retrenchment has occurred, the answer appears to be no. As Paul Pierson puts it in one of the earliest and most influential assessments, "Economic, political, and social pressures have fostered an image of welfare states under siege. Yet if one turns from abstract discussions of social transformation to an examination of actual policy, it becomes difficult to sustain the proposition that these strains have generated fundamental shifts."[7]

The reason for this is simple—at least in the view of Pierson and others who have followed his lead. Cutting back the welfare state is much harder than building it up. Social programs are popular, and they give rise to powerful constituencies well positioned to fight retrenchment. To buttress this simple but powerful argument, scholars of retrenchment have extensively examined efforts to introduce cutbacks into existing programs, using both qualitative case studies and multivariate statistical techniques.[8] Their main findings confirm Pierson's initial claim: dismantling the welfare state is a nonstarter.

For all its virtues, this argument has real limits. The first and simplest is its emphasis on authoritative change in existing programs. Although this may seem an obvious approach, it excludes from consideration a host of subterranean means of adjustment that can occur without formal policy change, from "bureaucratic disentitlement" caused by the decisions of front-line administrators to decentralized cutbacks in benefits caused by the actions of private benefit sponsors and providers.[9]

Perhaps more important, in emphasizing affirmative decisions, the conventional approach also excludes from consideration a wide range of agenda-setting and blocking activities that may well be crucial in shaping the welfare state's evolution. Most critical in this regard are deliberate attempts to prevent the updating of policies to reflect changing social circumstance. In the early 1990s, for example, the United States hosted a bitter debate over the future of American health insurance. Advocates of expanded government responsibility, led by Democratic president Bill Clinton, embarked on an ambitious campaign to extend health coverage to counteract the declining reach of private benefits. Their efforts, in turn, fell victim to a concerted countermobilization among affected interests and conservatives, who denied that government should step in to deal with the increasing hardships caused by skyrocketing costs and dwindling protections. Whether the campaign for universal health insurance was necessary or unnecessary, poorly executed, or simply doomed to fail, its defeat had enormous implications for the scope and character of U.S. social protection. Yet from the standpoint of the conventional approach to retrenchment, the failure of health care reform is a nonevent.

This example only hints at the broad range of processes and outcomes that a single-minded focus on formal policy change occludes. Historically, welfare states have been directed not just at ensuring protection against medical costs but also at providing security against a number of other major life risks: unemployment, death of a spouse, retirement, disability. Yet the incidence and extent of many of these risks have changed substantially over the past three decades, leading to potentially significant transformations in the consequences of social policies, even without formal changes in public social programs.

Furthermore, even within the relatively narrow conception of the welfare state that most research employs, some important policies routinely get left out. Notable here are two overlapping policy realms that are central to the U.S. social policy framework: tax breaks with social welfare purposes and regulatory and tax policies governing privately provided social welfare benefits.[10] Controlling for tax burdens, for example, private workplace benefits constituted more than a third of U.S. social spending in 2001—by far the highest level in the advanced industrial world.[11] In 2006 the cost to the federal treasury of subsidizing these benefits through the tax code exceeded $300 billion, about what is spent on the Medicare program.[12] Moreover, these benefits have changed dramatically in the past generation, as corporations have unilaterally cut back benefits or shifted toward less secure income guarantees. Thus leaving policies that govern private benefits out of the analysis entirely, as nearly all retrenchment studies do, misses a critically important dimension of social policy change, particularly in the United States.

Private benefits are provided at the discretion of employers within a framework of government inducements and constraints. As a result, most changes in such benefits occur without formal policy revision. Like the other less visible sources of change just discussed, therefore, the evolution of private benefits calls for an analysis that is attuned to the internal reworking of otherwise stable policies and to the shifting interaction of policies and their environment.

This is, of course, a formidable challenge. Researchers are a long way from having good data on shifts in benefit rules, much less on how these rules are implemented or actually affect citizens. Still, the shortcomings of the conventional approach to retrenchment suggest some straightforward prescriptions. First, attention should focus not only on the structure of policies but also on their effects—not only on the rules governing benefits or eligibility but also on the outcomes that those rules produce as they are carried out by front-line policy actors in the context of shifting social conditions. Second, and no less important, *explanations* must take seriously the possibility that those who wish to change policies will seek to do so without formal revision, attempting instead to alter policies through less visible means.

Such strategies of stealth can follow three main courses: (1) "convert" existing policies by changing the way they are carried out on the ground, (2) "layer" new policies on top of old ones so as to change the operation of the old, and (3) abet the "drift" of policies away from their original purposes by blocking attempts to update existing policies to new social circumstances.[13] In an environment of new or worsening social risks, opponents of expanded state responsibility do not have to enact major policy reforms to move policy toward their favored ends. Merely by delegitimizing and blocking compensatory interventions designed to ameliorate intensified risks, they can gradually transform the orientation of existing programs, allowing these programs to drift away from their original mission. Each of these forms of subterranean change—conversion, layering, and drift—has been on vivid display in the post-1970s privatization of risk in U.S. social policy.

The Welfare State Confronts New (and Newly Intensified) Social Risks

The constellation of risks citizens face has changed significantly in the past three decades, owing to linked changes in work and family. One set of changes has occurred in the labor market, which has become both more unequal and more uncertain, with cyclical unemployment gradually giving way to structural employment. In cyclical unemployment, workers are laid off or lose jobs when the economy sours but are able to return to work at a similar job in the same industry, and sometimes even with the same employer, when the economy improves. Today, however, job loss is more likely to be persistent. Workers are less often able to return to a similar job in a similar industry, so unemployment frequently ends only when workers accept a new job that requires major cuts in pay, hours, or both.

This trend shows up in a number of places. Although the unemployment rate has remained historically low in recent years, the rate of involuntary job loss (defined as "worker terminations as a result of business decisions unrelated to the performance of the particular employee") has actually been rising.[14] In the 2001 recession, the rate of involuntary job loss rivaled the levels reached in the early 1980s, during the deepest recession since the Great Depression.[15] The last two recessions, of 1990–91 and 2001, also featured historically high levels of unemployment lasting six or more months. Traditionally, long-term unemployment has peaked six to eight months after a

recession ends. In the recession of the early 1990s, however, long-term unemployment peaked nineteen months into the recovery. After the 2001 recession, long-term unemployment peaked twenty-nine months in.[16]

The consequences of job loss are also more severe than they once were. More than a third of workers involuntarily displaced between 2001 and 2004 (notably a period of economic recovery) failed to find employment, and 13 percent found only part-time work. Even full-time workers who found full-time jobs—the best-case scenario, as it were—ended up earning around 17 percent less than they would have had they not been displaced, a bigger loss than recorded during the early 1980s.[17]

A major reason for the discrepancy between the unemployment and job-loss figures is that many of those displaced from the labor market are not "actively seeking work" and hence are not formally unemployed. Yet there is good evidence that many of these potential workers would be in the labor force were the opportunities for them greater. In 2005, according to Katharine Bradbury of the Federal Reserve Bank of Boston, the total labor force "shortfall"—compared with similar points in the business cycle in the past—was as high as 5.1 million men and women.[18] This amount would raise the official unemployment rate to 8.7 percent, a level not seen since the steep recession of the early 1980s.

The second major shift that appears responsible for increasing family economic volatility is the transformation of the family—most notably the dramatic movement of women into the workforce.[19] This may come as a surprise. Much of what economists write about the family assumes that increasing workforce participation by women serves as a form of private risk sharing, in that it allows families to better deal with shocks to income.

Although two-earner families do enjoy special advantages when it comes to private risk sharing, they can scarcely eliminate economic risk—and in some important ways, two-earner families face special risks of their own. This is partly because the world has not stood still as women have entered the workforce. In the idealized view of two-earner families, couples "diversify" risk by deciding to jointly enter the workforce and then purchase private substitutes for the previously unpaid labor provided by stay-at-home moms. In reality, the choices of two-earner families have not been as unconstrained as this idealized picture suggests. To most families today, a second income is not a luxury but a necessity in an era in which wages have been relatively flat and the cost of basic expenses has been rapidly rising.[20] In time-use surveys, both men and women who work long hours indicate they would like to work fewer hours and spend more time with their families—which strongly suggests they are not able to choose the exact mix of work and family they would prefer.[21]

Moreover, although two-earner families are less likely to experience a catastrophic drop in income, they are more likely to experience smaller fluctuations in income. After all, if every worker has an equal chance of experiencing a drop in income, a family with two workers has a substantially greater chance of experiencing an income shock. To be sure, the drop in family income is smaller than it would be if the worker experiencing it were the sole breadwinner. But it is still a more likely occurrence. A person may never lose all of his or her eggs when they are in more than one basket, but the likelihood of losing at least some of them is greater.

In addition, two-earner couples are often parents as well as workers, making the tradeoffs even starker. If both parents work, who stays home when a child gets sick? If both parents work, what happens to family finances when one leaves the workforce to raise a new baby or care for young children or elderly parents? In short, when both parents work, events within the family that require the love and care of family members produce special demands and strains that traditional one-earner families did not generally face.

Finally, women's movement into the workforce has changed not just the character of parenting but also the economic relationship between spouses, encouraging greater equality within the household and increasing the ability of women to support themselves and children outside of marriage (despite the endurance of a substantial gender gap in earnings). Across the Western world, divorce has become more common precisely when and where women's participation in the labor force has expanded.[22] This is not to suggest that law and culture are immaterial, only that the increased instability of American families has important roots in the expansion of female economic autonomy.

One sign of these changes can be gleaned from the characteristics of people in poverty. Although poverty rates dipped in the strong economy of the late 1990s, they rose over the 1970s and 1980s and are rising again. No less striking than the overall rise is the change in the characteristics of those affected: poverty among the elderly fell sharply in the 1970s and has remained relatively low since, while a sizable and increasing portion of the poverty population is made up of parents with young children.

A similar but in many ways more nuanced portrait is provided by the number and characteristics of Americans filing for bankruptcy. As is well known, personal bankruptcy has risen sharply, with filings increasing more than fivefold between 1980 and 2002, to more than 1.5 million. (In 2005

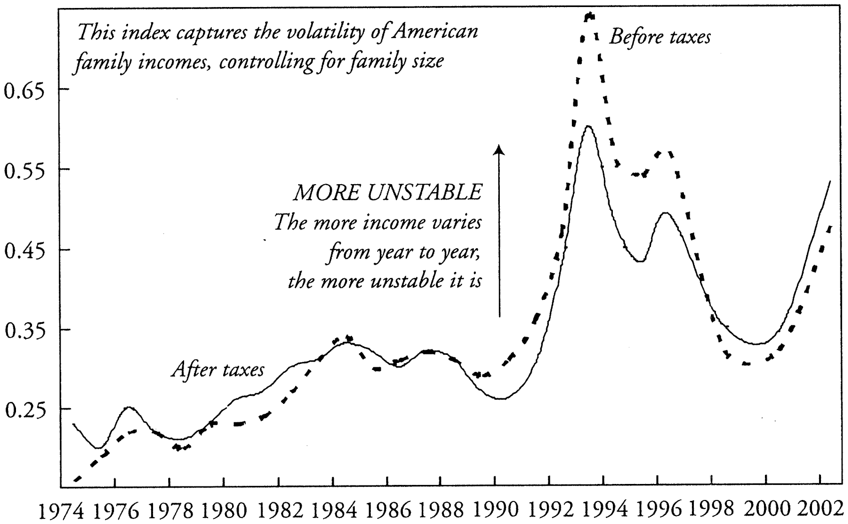
the total topped 2 million, though many of these filings represented the rush to file before the new bankruptcy law passed by the Republican Congress and signed by President Bush in early 2005 tightened the rules for filing.) Meanwhile, the mortgage foreclosure rate has increased fivefold since the early 1970s, and levels of personal debt have risen to record levels.[23]

It is less well known that the characteristics of bankruptcy filers have also changed dramatically. Women, for example, have emerged as the largest single group of filers, their share of filings rising eightfold between 1981 and 2001. Although unmarried women with children are the most likely household type to file, married couples with children are not far behind, with filing rates more than twice that of men and women without children (married or not). Revealingly, half of filers cite health problems, childbirth, a death in the family, or substantial medical bills as a prime reason for filing.[24] By comparison, a 1970s study found just 11 percent of filers citing one or more of these reasons in 1964.[25]

The rise in economic inequality and the changing character of the poor and bankrupt are each strongly suggestive of the changing composition of social risks that citizens face. Perhaps the most telling evidence of increased economic insecurity is the growing *volatility* of family incomes. Along with Nigar Nargis of the University of Dhaka, I have examined the variability of family incomes using the Panel Study of Income Dynamics (PSID), a data set managed by the University of Michigan that has been tracking a nationally representative group of households since the late 1960s. The PSID data are valuable because most government statistics—such as the unemployment rate, the poverty level, and the distribution of annual income—are "snapshots" of what people are experiencing at a given time rather than "moving pictures" of what happens to people over a period of several years. Because the PSID tracks families over time, it provides a true dynamic record of the up-and-down trajectory of Americans on the economic ladder over the course of their lives.

What this picture shows is that families are not merely pulling apart economically—as the well-documented rise in inequality shows. They are also experiencing greater income instability *over time*. Since the early 1970s, as figure 5-1 shows, family incomes in the United States have become much more volatile. Volatility is higher for women than for men, higher for blacks and Hispanics than for whites, and higher for less educated Americans than for more educated Americans. Furthermore, volatility has risen across all these groups and almost as quickly among the educated as among the less educated. It has also risen faster than economic inequality over the past generation.

Figure 5-1. *Increasing Instability of American Family Incomes, 1974–2002*[a]



Source: Panel Study of Income Dynamics, University of Michigan; Cross-National Equivalent File, Cornell University.

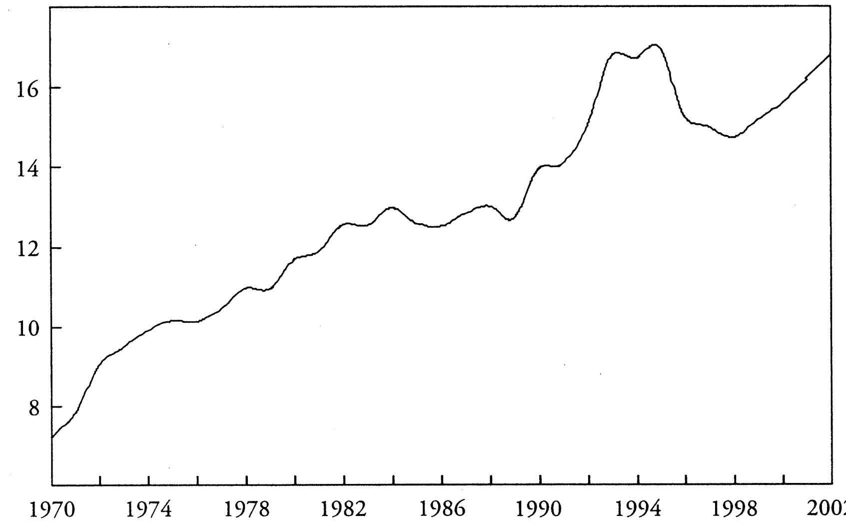
a. In all the analyses, family income includes taxable income received by the head of the household, the wife, or the spouse of the head, and other members of the family unit; cash public benefits received by family members; and private transfers, such as alimony. Family income is adjusted for changes in family size by dividing by the square root of family size—a common equivalence scale. This allows family-level income to be converted to individual-level income for the purposes of variance estimation. All the income variables are adjusted to account for inflation. In all the analyses, families with zero or negative income are dropped. All the analyses are also restricted to families whose heads were aged twenty-five to sixty-one in the year under study.

Drops in family income provide an even better sense of the serious economic risks that rising volatility represents. About half of all families in the PSID experience a drop in real income over a two-year period, and the number remains fairly steady. Yet the median drop—larger than half of drops and smaller than half—has risen from a low of around 25 percent in the 1970s to around 40 percent. A more precise multivariate regression shows the probability of at least a 50 percent drop in family income for individuals with average characteristics. As figure 5-2 shows, this predicted probability was 7 percent at the beginning of the 1970s. By the early 2000s, it had more than doubled, to around 17 percent.

To be sure, greater instability could reflect increased social mobility, or it could represent a largely benign side effect of rapid increases in family

Figure 5-2. *Predicted Chance of a 50 Percent or Greater Income Drop for Average Americans, 1970–2002*[a]

Chance for average person



Source: Panel Study of Income Dynamics, University of Michigan; Cross-National Equivalent File, Cornell University.

a. Probabilities are based on the time trend from a logistic regression, with all other variables set at their annual means. Variables include age, education, race, gender, income (mean of five prior years), and a series of events (such as unemployment and illness) that affect income. The time trend is highly significant and robust to the inclusion of fixed effects; all standard errors are robust and adjusted for clustering.

incomes. Unfortunately, neither of these sunny interpretations of rising income volatility is warranted. The extent of social mobility in American society remains a subject of heated dispute, but analysts generally agree that social mobility is no higher today than it was a generation ago, and perhaps lower. Nor does it appear higher in the United States than it does in other advanced industrial nations. Quite the opposite: among nations for which good comparative evidence exists, only South Africa and Britain have experienced a little upward mobility across generations.[26]

On the other hand, family incomes *have* certainly increased since the late 1970s—particularly at the top of the economic ladder. Yet in the middle of the economic ladder, the average rise has been surprisingly modest: median family incomes increased by about 15 percent between 1979 and 2000. Furthermore, about three-quarters of the rise in median family income can be accounted for by the increasing work hours of women. Median families are richer.[27] But they are richer not mainly because workers are earning more but because they are working more hours than they used to.

In short, the high levels of economic instability seen today are not the result of massively improved social mobility or runaway prosperity for the middle class. Instead, they appear to result from the complex interaction of rising job instability and the transformation of the American family, which have together increased the risks to income faced by most Americans.

Public Inaction—and Private Retreat—in the Face of Rising Risk

What can be said with certainty is that existing public and private policies are not adequately protecting families against economic instability in a new era of work and family. One revealing piece of evidence is provided by the PSID data just discussed: whereas family income drops were substantially cushioned by government taxes and transfers in the 1970s, that is far less so today. To be sure, this may partly reflect the growing role of in-kind benefits, which are not included in the PSID. But it seems clear that, at least when it comes to income protection, the government is not doing as much as it once did to help families that experience economic shocks.

In principle, U.S. social policy could have adapted to changing realities. In recent decades, some nations have increased their provision of services that help families balance work and child rearing. Many of these same nations have also tackled the new realities of the labor market with active employment and training polices. Putting aside some exceptions, however, the United States has clearly not followed this path. Increases in the Earned Income Tax Credit for low-wage workers, shifts of money from cash assistance to child care and job retraining, and new family leave legislation were all steps toward a response. But low-wage workers continued to receive only meager public supports. Family leave rules did not apply to small employers and did not provide income support to leave-takers. Government assistance for child care remained scant and frequently unavailable, even for eligible families. Despite newly intense job insecurity, unemployment insurance contracted. And while failing to uphold the direst predictions, the welfare reform legislation of 1996 removed important elements of the safety net for the most disadvantaged. Perhaps most striking was a massive decline in employment-based health and pension protections among lower-wage workers—which was only weakly offset by public coverage expansions.

A partial glimpse into these trends is provided by the cross-national measures of redistribution provided by the Luxembourg Income Study (LIS).[28] The LIS statistics show that inequality before taxes and transfers rose sharply during the 1980s and 1990s in the United States, which has the highest levels of inequality among nations in the LIS. Yet compared with other nations, the United States appears to have done much less to offset the rise in inequality that many nations experienced during this period. Averaging across the thirteen other nations for which LIS data exist, for example, the reduction in inequality created by taxes and transfers increased 4.5 percent over the 1980s and 1990s. In the United States, by contrast, taxes and transfers reduced inequality 4.4 percent less by the end of the series (2000) than at the outset (1986).

This is an incomplete measure, of course. But its message is confirmed by the review presented in the next two sections, which takes a closer look at recent developments in the two largest areas of U.S. social policy: health insurance and pensions. These policy areas not only account for the majority of social spending in the United States (and, indeed, in all affluent democracies). By virtue of their size and unambiguous popularity, they are also widely seen as the most resilient components of the postwar welfare order. Yet in both these bedrock areas, relative stability in public programs has masked major declines in the ability of social policies to provide inclusive risk protection. Social risks have shifted from collective intermediaries—government, employers—onto individuals and families. Efforts to address new and newly intensified risks have failed. New policies sharply at odds with established ones have been created and expanded. Although the paths of health and pension policy differ in revealing ways, their overarching trajectories appear to be moving in the same direction: toward a significant privatization of risk.

The Unraveling of American Health Insurance

By the 1970s, the basic structure of American health insurance was firmly in place. For most Americans—more than 80 percent by the mid-1970s—private health insurance provided the first line of protection against the risks of medical costs. Employment-based health protection was (and is) heavily subsidized through the tax code, which treats virtually all workplace health benefits as exempt from taxation as compensation. (The revenue loss created by this tax break was roughly $188.5 billion in 2004.)[29] From 1965 on, the federal Medicare program provided public coverage for the elderly—and, later, the nonworking disabled—and the joint federal-state Medicaid program covered poor people on public assistance, the working disabled, and the indigent aged.

Since the 1970s, the private foundation of this system has undergone a radical contraction—in what amounts to a textbook case of drift within the bounds of stable formal policies. From a peak of more than 80 percent of Americans, private insurance coverage fell during the 1980s and early 1990s to less than 70 percent. Employment-based protection was the biggest casualty: Between 1979 and 1998, the share of workers who received health insurance coverage from their own employers fell from 66 percent to 54 percent.[30] At the same time, employers have grown less willing to cover workers' dependents, and they have required workers to pay a larger share of the cost of coverage, which has discouraged some from taking coverage even when it is offered. The result has been a marked rise in the number of Americans without health insurance.

The gravest effects have been felt by those most disadvantaged by the economic trends of the past three decades. The share of workers in the lowest 20 percent of the wage spectrum receiving health insurance from their employers, for example, fell from almost 42 percent to just over 26 percent between 1979 and 1998.[31] These trends reflect multiple factors, including declining unionization and changing employment patterns. But above all, they mirror the simple reality that medical costs have risen much faster than median wages, outstripping the ability of workers and their employers to finance protection. With employers free to drop coverage, and workers under financial pressure to decline it even when it is offered, the risk of medical costs is being shifted from insurers and employers onto workers and their families.

This view is reinforced by one of the most fundamental transformations in American health insurance since the 1970s: the rise of "self-insurance" among employers. As already discussed, corporate self-insurance—the paying of medical claims directly—was encouraged by the 1974 Employee Retirement Income Security Act (ERISA), in that its so-called preemption clause protects self-insured health plans from most state insurance regulations and lawsuits in state courts.[32] But an additional crucial underlying motive for self-insurance has been the desire of larger employers to limit the cross-subsidization of the medical expenses of workers outside their own employment pool. Self-insurance has thus seriously worsened the situation of smaller employers, whose employment groups are too small to self-insure safely, while encouraging private insurers to weed out subscribers with high expected costs. The chronically ill, near-elderly, and those with expensive conditions have all faced increasingly serious barriers to obtaining insurance as a result.

Meanwhile, employers (and in some cases unions, which jointly manage many self-insured plans) have worked with conservative politicians to beat back any attempt to revisit the provisions of ERISA that exempt self-insured health plans from regulation. The ERISA Industry Committee, an organization of large employers created in 1976, has been perhaps the most vociferous champion of the preemption clause, supporting "legislation that preserves and strengthens ERISA preemption and reduces government interference with employers' efforts to provide cutting-edge, comprehensive health care benefits to their employees."[33] As a consequence, government regulation of private health plans has changed relatively little since the mid-1970s, despite a massive swing away from inclusive risk protection in the private sector.

Although Americans' prime source of health protection is eroding, public programs have by and large failed to fill the gap. Medicare—a centerpiece of U.S. social insurance—has essentially been caught in a holding pattern. Its popularity and the veto-ridden American political structure have prevented radical retrenchment, but it has grown increasingly inadequate as costs have rapidly outstripped the program's constrained spending. In a striking demonstration of the program's drift, Medicare beneficiaries pay more for medical care today than they did at Medicare's passage. At the same time, employment-based coverage for retirees and supplemental private benefits have been in a tailspin, as insurers and employers find that they cannot bear the risks Medicare does not cover. These risks are thus shifting by default to beneficiaries and their families.

Medicare has not been static, of course, and in 2003 prescription drug coverage was added to the program. The Medicare drug plan will reduce the total out-of-pocket spending of Medicare beneficiaries, but the effects are likely to be quickly swamped by rising drug costs, in part because the plan features substantial gaps and in part because it relies on private health plans that will have limited market reach (and indeed explicitly forswears using Medicare's concentrated purchasing power to hold down costs).

Medicare contracting with private health plans may eventually represent a threat to Medicare's broad risk pooling. Since contracting's origins during the Reagan administration, conservatives have aggressively pushed to transform it into a full-fledged system of competing, risk-bearing private plans, which they hope will undermine the unified constituency that has blocked direct benefit cuts in the past. Although studiously careful not to challenge Medicare head-on, the strongest advocates of a competitive system clearly believe that the traditional program should, as Republican House Speaker

Newt Gingrich infamously put it in 1995, "wither on the vine." (Gingrich was, in fact, unusually candid about Medicare reformers' covert strategy, noting that "we don't get rid of [Medicare] in Round One because we don't think it's politically smart.")[34]

Another potential threat to broad risk pooling in American health insurance—and a classic example of the "layering" of new benefits onto existing options—is the move toward so-called health savings accounts (HSAs, also known as medical savings accounts). A darling of conservative policy advocates since the early 1990s, HSAs are high-deductible "catastrophic" insurance policies that are coupled with tax-favored savings accounts in which patients save for routine medical expenses. In his 2005 State of the Union Address, President Bush called for a major expansion of federal tax breaks for such accounts, calling for substantial spending on top of the $16 billion over ten years that was devoted to expanding enrollment in HSAs for the nonelderly in the 2003 Medicare prescription drug legislation. While enrollment has historically been low, it rose from roughly 1 million to about 3 million between March 2005 and January 2006, and some projections suggest it will reach 15 million by 2010, or a tenth of the insured. A 2005 survey of employers found that 40 percent of large employers not currently offering an HSA are "somewhat" or "very" likely to offer one in the next year.[35]

HSAs are a threat to broad risk pooling because they are likely to be most attractive to healthier and wealthier individuals. Both existing research and surveys of employers suggest that HSAs will disproportionately attract healthy, higher-income workers who are already insured in the private, employment-based insurance market (most of the uninsured, in contrast, are unlikely to receive any tax benefits for establishing an HSA). The movement of such workers into HSAs would undermine employment-based plans, leaving them with a less healthy mix of workers. HSAs are thus another vehicle for privatizing risk without directly confronting existing benefit programs

At the same time, coverage of the poor has unquestionably grown: first, with federally mandated extensions of Medicaid in the 1980s; and second, with the creation of the state-federal Childrens' Health Insurance Program (CHIP) in 1997. These were important expansions, all the more remarkable because they occurred in such a hostile climate. Before ending the story, however, I should emphasize three points. First, the expansion of Medicaid has only partly offset the decline in private coverage. Second, the trend toward expanding coverage appears to have run its course: even before the 2001 economic downturn, enrollment in Medicaid had slowed dramatically. And third, the 1996 welfare reform bill has created a massive exodus from the welfare rolls, with those who leave moving into the low-wage employment sector, where private coverage is rare. Millions eligible for CHIP and Medicaid are not enrolled, and this is likely to become truer as time limits on welfare kick in. Overall, the share of children who are uninsured has remained remarkably constant in the face of public coverage increases.[36] In sum, Medicaid and CHIP appear more like band-aids on a festering wound than an inexorable expansion of public protection.

In strategic terms, critics of Medicaid have been greatly aided by the joint federal-state structure of the program, which has facilitated cutbacks by fostering interstate competitive pressures in favor of budgetary stringency while making cutbacks more difficult to identify and assign responsibility for. Since 2000, the Bush administration has aggressively used federal waivers to encourage state-based program restructuring and to shift from the current guaranteed matching formula to so-called block grants, in which the states are provided a fixed amount of funds. Like Medicare reform, Medicaid block grants last became a major issue in the mid-1990s. Then, as now, advocates of block grants espoused "an ideological commitment to shrink the welfare state and return power to states from Washington."[37]

No discussion of the recent evolution of U.S. health insurance is complete without mention of the stunning defeat of the Clinton health plan—arguably the most dissected legislative failure in modern history. Rather than rehash the saga, I wish simply to emphasize that its defeat represents perhaps the best evidence of politically mediated policy drift. The Clinton health plan and its major competitors reflected a belief that the American policy of relying on voluntary employer provision of health benefits was increasingly unworkable as a secure foundation for risk pooling. The opposition to the plan, centered among hard-core political conservatives, employers, insurers, and private medical interests, in turn reflected not simply the recognition that many of these groups would be immediately hurt by the plan but also the awareness that its passage would create a new and valued entitlement for anxious middle-class and working-class voters whose long-term political allegiances were very much up for grabs. Thus conservative activist William Kristol warned that the Clinton plan would "relegitimize middle-class dependence for 'security' on government spending and regulation" and "revive the reputation of . . . the Democrats . . . as the generous protector of middle-class interests."[38] On the other side, Clinton explicitly cast his crusade as an effort to undo the policy drift of the past two decades—drift that had created, in the words of the White House's *Health Security* report, "growing insecurity." "From the 1940s through the 1970s," the report explained, "the

United States made steady progress toward broader health care coverage. . . . Beginning in the 1980's, however, the number of Americans lacking health insurance has increased steadily—while health care costs have increased at ever-rising rates."[39]

In the end, the Clinton plan was brought down by much the same dynamic that stymied conservatives' efforts to dismantle public programs: the easily ignited fears of Americans that reform would compromise the social protections on which they relied—in this case, private insurance. But what is crucial is that U.S. leaders debated whether social policy would adapt to the changing job market and declines in private protection. Although the privatization of risk in American health insurance occurred without major policy reforms, it was very much a matter of political struggle.

In sum, when one considers the broader framework of U.S. risk protection in health care, the direction of change is clearly toward a marked narrowing of the bounds of collective protection, driven principally by the politically mediated drift of policies away from their original scope and purpose. To be sure, major public programs have been preserved. The demise of conservative efforts to scale back Medicare and Medicaid in 1995 is a powerful illustration of the hurdles thrown up by American political institutions and the enduring popularity of established programs. But resilience in the overall framework of American health insurance has not prevented a major shift in the distribution and intensity of the risks faced by citizens. The Medicare program has stagnated in the face of rapidly rising costs. The Medicaid program has expanded, but not nearly enough to offset the implosion of private coverage. There has been a massive decline in private health protection, which has increasingly ceased to be available or affordable for lower-wage workers. Serious efforts to deal with this have been effectively blocked by a formidable constellation of ideologically committed opponents and vested interests, which have pushed for individualized private accounts instead. The outcome has been a significant privatization of risk.

Individualizing Retirement Security

The American approach to retirement security is also a public-private hybrid, blending public social insurance and employment-based benefits—and, increasingly, tax-favored savings accounts. But pension policy differs crucially from health policy in the respective roles of public and private benefits. Whereas Medicare and Medicaid emerged after the large-scale development of private health insurance, private retirement pensions were by and large built on top of the public foundation of Social Security.[40] This supplementary role was embodied most concretely in the practice of "integration," in which employers that qualified for tax breaks for their private retirement plans were allowed to reduce pension benefits sharply for lower- and middle-income workers to reflect expected Social Security benefits. It was also embodied in the 1974 ERISA statute, which regulated private plans to ensure that they would be secure counterparts to the public foundation established by Social Security.

This vision of the division of labor between public and private still has relevance, but it is much less accurate or widely shared than in the past. First, since the 1970s, Social Security has been under serious financial pressure. Slower wage growth and increases in the ratio of retirees to workers precipitated the passage of two major legislative overhauls, in 1977 and 1983. While preserving the program, albeit at reduced levels, these reforms have effectively ended its expansion.

Second, employers have rapidly shifted away from the traditional "defined-benefit" plans that were the subject of ERISA. Instead, they have adopted so-called defined-contribution plans that are not tied to Social Security and, unlike defined-benefit plans, place most of the risk of investment onto workers themselves. Although this momentous transformation is mostly a case of conversion, in which employers have restructured their plans within relatively stable federal guidelines, it is important to note that defined-contribution plans were enabled and greatly encouraged by new and expanded federal tax subsidies layered onto the existing retirement system during periods of conservative ascendance. As in the health insurance field, there has also been a major decline in employer support for retirement benefits and, in tandem, a major privatization of risk.

As employers have moved away from defined benefits and decreased their commitment to pensions since the 1970s, their pension contributions have significantly decreased as a share of pay. Like the decline in private health insurance, the fall in pension contributions is symptomatic of the broader reversals in the economic outlook of less-educated workers. Between the early 1980s and the mid-1990s, the value of pension benefits to current workers dropped in every income group, but by far most rapidly among the lowest-paid workers, who already had the lowest coverage levels. In addition, tax breaks for private pensions and other retirement savings options heavily favor better-paid employees: two-thirds of the more than $120 billion in federal income tax breaks for subsidized retirement savings options accrue to the top 20 percent of the population.[41]

Although the post-1970s economic transformation was the underlying spur for these changes, its impact has been deeply mediated by politics. The 1980s signaled the beginning of an ongoing tug-of-war between two increasingly homogenized and polarized parties, with Republicans seeking to create and liberalize individual retirement options and Democrats fighting to place new restrictions on existing pension tax subsidies and to limit the top-heavy skew of individual accounts. The overall thrust of policy has nonetheless been in the more conservative direction—toward the expansion of tax-favored plans and toward the loosening of restrictions both on eligibility for them and on the purposes for which they can be used.

The path of individual retirement accounts (IRAs) illustrates the overall pattern. Included in ERISA as a retirement savings device available only to workers without private coverage, IRAs were expanded and made available to all workers in the early 1980s. In 1997 and 2001, they were liberalized again: permissible uses of the accounts were broadened to include education and housing expenses, and a new plan—called "Roth IRAs"—was created that would require account holders to pay taxes up front and then avoid all future taxes on their accounts (including estate taxes). Since, at the time, the vast majority of Americans already could establish traditional IRAs, the main effect of these changes has been to make tax-favored accounts more available and attractive to upper-income households.

The story of so-called 401(k) plans is different but similar. The 401(k) plan is a defined-contribution plan that operates under section 401(k) of the tax code—a provision added with little debate in 1978. In 1981 a private benefits expert pressed the IRS to rule that the provision extended to pensions in which workers put aside their own wages, much as in an IRA. The Internal Revenue Service under Ronald Reagan agreed, and corporate sponsorship of 401(k) plans exploded. In 2001, as part of that year's tax reduction plan, Republicans successfully pressed for liberalization of 401(k)s and IRAs, and for the creation of "Roth 401(k)s" similar to Roth IRAs.

Behind the explosive growth of 401(k) plans and IRAs over the past decade lies a new conception of pensions, for these retirement accounts have few of the characteristics of either Social Security or older defined-benefit plans. These accounts are voluntary for individual workers, participants have a significant degree of control over investment choices, and benefits are often paid as a lump sum upon employment separation or achievement of a specific age and, increasingly, can be accessed for purposes besides retirement. Because they are voluntary, many younger and poorer employees who are offered them choose not to participate or contribute little. And the risk of poor investment decisions or bad financial luck falls entirely on participants—as became painfully clear in the wake of the recent stock market downturn.

The strength of the stock market in the 1990s obviously helps explain the enthusiasm for individualized investment accounts. But the shift must also be seen as rooted in linked economic and political developments of the past two decades. By the 1980s, defined-benefits pensions no longer offered the attractions to employers that they had in the more stable employment climate of the 1950s and 1960s, with its strict managerial hierarchies and large, unionized manufacturing firms. Nor, as Social Security's tax-to-benefit ratio grew less favorable, did employers have a strong incentive to set up integrated plans whose expense would be partly offset by the federal program.

No less important are the political motives that lie behind the expansion of private accounts. For years, conservatives despaired of ever effectively challenging Social Security. Even at the height of Reagan's influence, the conservative push for reform was quickly crushed by the weight of past programmatic choices. However, these past defeats fostered a new awareness on the part of critics that Social Security could be fundamentally reformed only if there existed a "parallel system" of private individual accounts that could eventually be portrayed as a viable alternative to the public program. Conservatives therefore retooled their strategy to encourage private retirement savings through ever more flexible and individualized means, acclimating Americans to private accounts and layering the institutional infrastructure for a full-fledged private system on top of the core public program of Social Security.

The strategic assumptions behind this approach have been carefully analyzed by Steven Teles, who argues that "conservatives have slowly built up counter-institutions, counter-experts, and counter-ideas . . . [in] an attempt to solve the political problem of social security privatization." The core of this strategy, Teles concludes, was to "carve out a competing policy path, one that would slowly undermine support for Social Security and preserve the idea of privatization for the day when it was politically ripe."[42]

Whether the day will ever be ripe remains a very open question. As President Bush's dismal experience in 2005 suggests, the reluctance of elected politicians to consider plans for even partial privatization of Social Security is overwhelming—all the more so in light of the federal budgetary turnaround. The difficulty of reforming mature pay-as-you-go-pensions, which stems from the massive expectations and accumulated fiscal commitments they embody, stands out as the ultimate example of programmatic path dependence and policy feedback. Nonetheless, these barriers should not distract our eyes from the significant change that has already occurred. With corporations and individuals shifting to more individualized plans, the explicit links between the public and private systems have steadily eroded, undermining some of the self-reinforcing mechanisms that previously secured Social Security's privileged position. And most American employers have lost their direct stake in the program's health, as their own plans have broken off from the public pension core around which they previously revolved. These transformations are perhaps most visible in the growing role of tax-favored retirement accounts linked to the stock market and in the changing balance of public and private pension benefits—a balance that tilted toward the private side of the scale for the first time in the 1980s. Whatever else these momentous shifts foretell, they clearly signal a major privatization of risk.

Economic Insecurity in an Age of Market Triumphalism

When Hurricane Katrina ripped through the Gulf Coast in September 2005, leaving death, grief, and wreckage in its wake, Americans were reminded that risk is an integral element of everyday life. For a moment, a sense of shared fate linked the nation, just as it had after the terrorist attacks of September 11, 2001. Money poured forth to charities. Volunteers inundated the area. Tears were shed over the plight of strangers. The issue was not one of personal responsibility; it was one of national responsibility.

When it comes to economic risk, Americans have, for almost a century, responded in the same way. The Great Depression of the 1930s—which left "a third of the nation," in FDR's famous telling, "ill-housed, ill-clothed, ill-nourished"—was widely seen as a natural disaster beyond the control or responsibility of the Americans it struck. In its wake, and especially after World War II, political and business leaders put in place new institutions designed to spread broadly the burden of key economic risks. These public and private institutions did not ignore personal responsibility. They required work, ongoing contributions, and proof of eligibility. But they were based on the ideal of "social insurance"—the notion that certain risks can only be effectively dealt with through inclusive institutions that spread costs across rich and poor, healthy and sick, able-bodied and disabled, young and old.

Today, however, this public-private framework is coming undone. As a new century begins, Americans are witnessing a major transfer of economic risk from broad structures of insurance onto the balance sheets of families. This transformation is reworking Americans' relationship to their government,

their employers, and each other, with consequences for politics and societ that promise to be profound.

The privatization of risk has implications not just for America's future, bu also for the recent evolution of its social policy. As I have shown, public socia programs have by and large resisted direct attacks in recent decades. Yet tha does not mean they have continued to play the role they once did. Instead critics of these programs have transformed them indirectly, through three primary means: "drift," the obstruction of efforts to recognize and respond t changing social risks; "conversion," shifting the ground-level operation o social programs in directions at odds with their initial goals; and "layering," the supplementation of existing programs with new policies that subvert o threaten older policies. The result has been a significant erosion of U.S. socia protection, despite the absence of many instances of major policy reform Since the American experience is widely considered to be the strongest evidence of welfare state resilience in the face of conservative opposition, this i a notable finding in itself. But it also sheds some light on welfare stat restructuring in other nations, and on the character, cause, and consequenc of policy reform more generally.

In extreme form, American developments provide a window into transformations taking place in many affluent democracies, as fiscally constrained welfare states confront new and newly intensified social risks. As the sociologis Gosta Esping-Andersen argues, the rise of such risks has strained the capacit of existing social welfare frameworks.[43] Yet, unlike Esping-Andersen and others who have examined the "new social risks," I have argued that this growin gap between risks and benefits is not simply a result of exogenous shocks t stable welfare states, but that it grows directly out of the politics of welfar state reform. By reframing debates, blocking new initiatives, and creating parallel policy paths that undermine existing programs, opponents of the welfar state have transformed U.S. social policy, even without achieving the large-scale reforms that retrenchment studies have searched for (and mostly foun lacking). For all the reasons that retrenchment scholars have highlighted—th status quo bias of political institutions, public attachment to existing programs, the powerful constituencies that broad government action creates—th privatization of the welfare state has largely proved a nonstarter. The privatization of risk, however, has proved much more politically feasible, and it mus be counted as a major victory for those who believe the welfare state is an outmoded and inefficient institution whose role should be reduced.

The ultimate irony is that in the new climate of economic and famil risks, the case for a robust framework of risk protection is stronger tha ever—and the case for thinking that this framework must have a central role for the government just as powerful. Today, America's public-private framework of risk protection is under strain, and most of that strain is coming from the erosion of private workplace benefits. It was once argued that the government was not needed to provide basic risk protection—that private insurers could take care of health care, that private employers would ensure that everyone had a good pension. No one can confidently hold that view today. The only question is whether the government should step in to assume the growing risks of America's flexible, dynamic economy, or whether Americans should be left to cope with these uncertainties largely on their own.

The argument for having the government pool these risks is powerful: enhanced social insurance could provide all Americans with the financial security they need to survive and thrive in a highly uncertain economy, encouraging workers to accept the downs as well as the ups of a largely unfettered free market. Without basic risk protections, workers and families may be tempted instead to support intrusive restraints on commerce and production, undermining the dynamic economy that the project of market reform was supposed to bring about. Moreover, social insurance programs like Medicare and Social Security feature low administrative costs and broad public acceptance and popularity. And because of the public sector's formidable bargaining power and unmatched standard-setting capacity, Medicare is also arguably better poised than private sector benefits to control health spending and encourage cost-effective medical utilization in the future.

But these arguments are hardly universally accepted. For those who believe that risk protection interferes with the free play of competitive forces, for those who believe that government insurance merely coddles people who make the wrong choices, the only solution is to shift even more risk onto Americans' shoulders. The great debate of the twenty-first century will be whether the privatization of risk should be halted or hurried. And the outcome may well determine not just the future of U.S. social policy, but that of the American model of capitalism as well.

Notes

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9. The term is Michael Lipsky's; see his "Bureaucratic Disentitlement in Social Welfare Programs," *Social Service Review* 58 (March 1984): 3–27.

10. Hacker, *The Divided Welfare State;* Christopher Howard, *The Hidden Welfare State: Tax Expenditures and Social Policy in the United States* (Princeton University Press, 1997).

11. The details of these calculations are provided in Hacker, *The Divided Welfare State,* appendix; updated OECD data are available, in spreadsheet form, at www.oecd.org/dataoecd/56/21/35632949.xls.

12. U.S. Office of Management and Budget, *Budget of the United States Government, Fiscal Year 2006: Analytical Perspectives* (GPO, 2005), table 19-1 (www.whitehouse.gov/omb/budget/fy2006/pdf/spec.pdf).

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