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Restoring the American Social Contract

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While the term "social contract" has not been widely used in America, the idea of some mutual obligation between society and the individuals that comprise it is deep-seated in the American view of society. It is true that America, more than almost any other country, is based on the idea that individuals should have the freedom to pursue their individual goals and use their talents for advancement. Nonetheless, the idea of America also is one of a society that involves both membership rights and obligations for its members.

This American version of the European idea of social contract envisions reciprocal obligations.

- The obligation as a society is to assure individuals that nobody will suffer unreasonable hardship because of factors beyond their control. While other societies have interpreted this obligation as a justification for extensive government protections and programs, in America we have traditionally based this obligation on the extensive network of civil society institutions, including family, church, and neighborhood association.
- The obligation of individuals who are helped by the wider society is to use that assistance responsibly and to try to return to independence and self-sufficiency.

In the 1930s, the civil society–based social contract was supplemented significantly with a financial commitment by the federal government in the form of Social Security, a social insurance program that linked financial obligations in the form of payroll taxes to a set of financial benefits paid primarily during retirement.

Talking Points

Restoring the American idea of the social contract means returning to the basic principles of mutual obligation within a framework that is financially responsible and just by:

- Transforming our existing social insurance programs into "true insurance," restricting the availability of benefits to those who really need assistance while strengthening the benefits for those who find existing assistance to be insufficient;
- Deciding how much of our resources we are willing to contribute to such programs, given America's economic resources and the other goals of our society;
- Stimulating greater individual responsibility by encouraging more private savings and insurance among middle- and upper-income individuals; and
- Empowering individuals and families to link the security and provision of health and financial protections to the civil society institutions with which they identify most closely.

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In the 1960s, of course, this financial social insurance system was again supplemented with Medicare.

Undermining the Social Contract

Concern about the nature and operation of today's social contract has grown in recent decades. This is because three broad developments began to conflict with the traditional American notion of a social contract.

First, we temporarily abandoned the two-way nature of mutual obligation in the case of our most basic anti-poverty programs. In the 1950s and 1960s, the notion of "welfare rights" took hold, including the notion that financial assistance to the poor should be a one-way obligation. We saw the results of that in growing welfare rolls, long-term dependence on poverty programs, and perverse incentives that exacerbated family collapse and intergenerational poverty. Fortunately, the work requirements and limits on the duration of welfare that were put into law in 1996 helped us to begin to put the welfare system back on track.

Second, the growing sense that employers should play a central role in providing protection against ill health and retirement costs—a sense encouraged by tax laws and regulations—has led to employer decisions becoming an increasingly critical element of the social contract. However, it has become clear that employers do not have the same "community of interest" with their employees that other civil society institutions have with their members.

Owners and employees do not typically have a shared interest and vision of the sort found, for example, among the members of a church or union. Moreover, there is not the same long-term connection between the place of employment and a family that occurs between an individual and other institutions. Thus, it has become clear that, as a proxy for the wider society and its obligations, employers are a less appropriate partner to the contract.

We see the results of this today in our increasing concern about employment-based health coverage. We worry that critical decisions over choice of plan and availability of care are not in the hands of families and that employer decisions do not necessarily reflect the interests of those families.

We have experienced similar worries for many years about the pensions system. Although the financial security of worker pensions is entwined with the financial condition of the employer, the financial interest of the company often conflicts with the financial security of the worker. When a firm gets into trouble, not only are the jobs of workers jeopardized, but their long-term financial security is at risk. One needs only to think of the Enron collapse to appreciate why putting all of one's eggs in the employer basket has been such a folly.

Third, we have begun to see the internal weaknesses and perverse incentives in the American form of social insurance. As pay-as-you-go social insurance systems mature in every country, they face a classic problem as the society ages: The outlays needed to pay for the promised benefits force the system into structural imbalance and huge unfunded obligations.

In America, this trend has been exacerbated by our political system, in which interest-group pressures have led to a widening disconnect between the revenue base for the programs and the increasingly generous benefits promised by Congress. Worse still, programs like Social Security and, in particular, Medicare have steadily come to be viewed as a system of generous benefits to the middle and upper-income classes rather than as a basic system of protection against uncertainty and need.

For these reasons, our social insurance programs have slowly created a massive and immoral shift of wealth and obligation from today's middle class to future generations. Medicare alone now has a $32 trillion unfunded obligation—a tab that is being passed to our children and grandchildren. Medicare and Social Security together now constitute an unsecured "mortgage" of $170,000 placed in the crib of every newborn American.

Needed: A Return to First Principles

If we are to restore the American idea of the social contract, we need to return to the basic principles of mutual obligation within a framework that is financially responsible and just. This will involve at least four steps.

First, we must gradually transform our existing social insurance programs into "true insurance."

This means that we should begin to restrict the availability of benefits in Social Security and Medicare to those who really need assistance while strengthening the benefits for those who find the existing assistance to be insufficient.

This step would return these programs to the basic principles of the American idea of the social contract, in which we all contribute as members of society to the protection of ourselves as individuals through social programs and the assistance is limited to what is needed to enable a person to return to independence. Today, Social Security and Medicare violate that basic principle.

Second, we need to decide as a nation how much of our resources we are willing to contribute to such programs, given America's economic resources and the other goals of our society. Today we do not do that. Major entitlement programs, such as Medicare and Social Security, are open-ended, one-way commitments in which an individual can legally claim benefits. They will be paid by society whether or not the individual needs them and without regard to the financial burden on future generations. These entitlements automatically preempt resources for other needs, such as education or defense.

We need instead a budget process that encourages lawmakers to set priorities and make rational decisions between competing priorities. To do that, we would have to make a number of changes in the laws governing the budget process. For example, Members of Congress today vote on a budget without being forced to consider any information about the long-term unfunded obligations that may occur as a result of their decisions and without having to vote explicitly on raising those obligations. That needs to be changed, with Members of Congress forced to vote up or down to authorize any increase in total unfunded obligations.

More broadly, we need to end the special status of entitlement programs that allows them to preempt all other needs, replacing open-ended obligations with fixed budgets. To be sure, it is appropriate to establish long-term budgets for programs designed to protect individuals, just as many other industrialized countries do, but these budgets must be real and limited and established in the context of other goals. And if spending begins to exceed the budget, then the budget will be adjusted—in competition with other regular budget goals—as benefits must be curbed and refocused.

Third, we need to stimulate greater individual responsibility by encouraging more private savings and insurance among middle- and upper-income individuals. For the most part, these individuals should not be relying on social programs except for unpredictable circumstances so severe that we would not ordinarily expect an individual to have saved or insured sufficiently.

Fourth, it is time to envision a different role for employers. A strong and effective social contract requires the society or subgroup of society within which the mutual obligation rests to have a common interest as the basis of mutual support. But the place of employment typically does not exhibit these characteristics, so we should empower individuals and families to link the security and provision of health and financial protections to the civil society institutions with which they identify most closely.

Individuals and families typically turn to trusted agents to guide them in making complicated and important decisions. They choose realtors to help them buy a house, a broker to manage their investments, or a college counselor to help them pick a college for their child. In each case, individuals need to be able to pick the agent with whom they feel most comfortable in entrusting these decisions.

Employers, however, increasingly are not ideal agents, given the often clashing interests of employer and employee. They are not a subset of the wider society that can be a good partner in the social culture.

On the other hand, the place of employment is a very practical location for the financial transactions associated with health insurance, retirement savings, and other elements of the financial social contract. Payroll deductions, savings plans, and premium payments can be accomplished very easily at the place of work. So a distinction should be made in the future between the employer's role as a clearinghouse or facilitator for transactions in the social contract and the employer's role as the decision-maker or sponsor.

In the future, therefore, it would make sense to retain some of these practical features associated with the employer while enabling the individual or family to choose other civil society institutions as the vehicle for mutual obligation. For instance, a family might obtain its health insurance through a group formed by a consortium of churches, which includes the family's own place of worship, or through the union the family has been a member of for many years.

But to enable this to happen, we must remove the barriers that stand in its way. In the case of health insurance, the tax code is the biggest culprit and requires structural reform to enable families to choose other agents and enroll in non–employment-based insurance and savings plans without today's tax penalties. It is important, in other words, to change the tax code to make it neutral between different civil society institutions, including employers, as options for individuals and families to coalesce in obtaining mutual support.

Conclusion

These four steps are among the important actions needed to restore the American social contract to its original principles as a bargain between society and the individual. Refashioned in this way, our American-style social contract would be based more solidly on institutions that individuals value as integral parts of their lives, with the government dimension appropriately limited, sustainable, and more just to future generations.

—Stuart M. Butler, Ph.D., is Vice President for Domestic and Economic Policy Studies at The Heritage Foundation. This Lecture *is based on remarks delivered at a panel discussion on "A New Social Contract" hosted by the Hamilton Project and* Democracy: A Journal of Ideas *and held at the Johns Hopkins University School of Advanced International Studies in Washington, D.C.*