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# YOU'RE IN GOOD HANDS WITH SOCIAL SECURITY

## But privatization proposals would unravel its ability to insure against loss of income, disability, and death

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President Bush's Commission to Strengthen Social Security, having apparently discovered that it can't rely on sound economics to defend partial privatization, has instead chosen to falsely discredit the existing program by suggesting it is a bad deal for African Americans and women. "[F]ailure to restructure Social Security poses a disproportionate threat to the overall retirement security of women," the commission stated in its July report, adding, "African Americans are disproportionately threatened by the financing shortfalls facing the current system." But the commission's tactic is transparently belied by facts: for the past 66 years, Social Security has offered a safety net for workers and their families in the event the primary source of family income is lost due to retirement, disability, or death. In these situations, women, children, low-wage workers, and African Americans benefit greatly from Social Security.

Social Security is a three-pronged insurance program: it insures against loss of income due to retirement, death, or disability. About two-thirds of Social Security's expenditures pay for retirement benefits. The average elderly household receives 58% of its income from Social Security, and without these benefits an additional 39% of the elderly would fall into poverty. Moreover, Social Security's retirement benefit program offers insurance both against low lifetime earnings, since lower lifetime earners receive relatively higher benefits than do higher lifetime earners, and against old-age poverty, since it pays guaranteed, inflation-proof benefits regardless of life expectancy. Low-wage workers and women (who tend to live longer than men and have lower lifetime earnings than men) benefit especially from these retirement insurance features.

Social Security is also a large disability and life insurance program —about a third of expenditures pay for survivorship and disability benefits—and African Americans, women, and children are the major beneficiaries. While

African Americans make up just 12% of the population, they constitute 18% of disability beneficiaries; women, who make up 52% of the population, constitute 72.3% of survivorship beneficiaries; and children under the age of 18—just 6% of the population—constitute 26.9% of survivorship beneficiaries and 22.1% of disability beneficiaries.

These insurance features make Social Security a good deal for the average worker in general and for low-wage workers and women in particular. The average rate of return from Social Security for workers born between 1956 and 1964 is 2.7%, substantially higher than the 2% that could be expected from a privatized system. For women the average rate of return is 3.7%, and for low-wage men it's 4.7%.

## Partial privatization will likely result in cuts to all benefits

Social Security privatization would be a bad deal for women, children, African Americans, and low-wage workers, since it would significantly weaken Social Security's insurance function. Diverting a portion of Social Security revenue into individual accounts will result in less income for Social Security itself, meaning that retirement, disability, and survivorship benefits will have to be cut. [1] It has been estimated that a diversion of 2 percentage points of payroll (out of a total of 12.4%) will require a cut in retirement, disability, and survivorship benefits of 41% for anybody who is younger than 55 next year (Aaron et al. 2000).

Indeed, past proposals for partial privatization generally included cuts in all three types of benefits. For example:

- One of three options put forth by the 1994-96 Advisory Council on Social Security (the personal security accounts (PSA) option) would have let workers divert 5 percentage points of payroll tax (or 40% of Social Security revenue) into individual accounts.[2] Cuts in retirement, survivorship, and disability benefits were proposed to offset the loss in revenue.

- In 1998, then-Senator Patrick Moynihan proposed a 2-percentage-point cut in payroll taxes, the savings from which workers could use to establish individual retirement accounts. Aaron and Reischauer (1998) estimated that the loss of income to Social Security would require a 20% across-the-board cut in retirement, disability, and survivorship benefits.

- Senators John Breaux and Judd Gregg also suggested partial privatization in which 2 percentage points of payroll would be allocated to individual accounts. To cover the income shortfall, retirement and disability benefits were to be cut substantially, by about 30% to 40% for high- and moderate-income workers (Aaron and Reischauer 2001).

## Individual account savings will not compensate for benefit cuts

The cuts to Social Security could be offset to some degree by savings in individual accounts. But these accumulated savings will on average cover only one-third to one-half of the loss in benefits (Aaron et al. 2000; Baker 2000).

The share of lost benefits a worker will be able to recover with the accumulated savings depends on several factors, the most important of which is the rate of return. Future real rates of return, though, are likely to be lower than in the past. Real rates of return on stock markets depend on economic growth, and Social Security's trustees assume that economic growth over the next 75 years will equal only half that of the past 75 years, 1.6% compared to 3%. Hence, real rates of return should be equally lower, meaning that we can expect an average rate of return of 3.6% for the next 75 years (Baker 1997).

Another factor cutting into rates of return on private accounts will be the administrative charges on individual accounts and premiums for private insurance to pay for survivorship and disability benefits. In addition, Social Security will be expected to honor promises made to workers who already paid into the system, therefore requiring current workers to pay twice, once into their own accounts and once for the benefits already promised. Consequently, the effective rate of return from stock market investments will be around 2% (Baker 1998), applicable to every worker regardless of demographic or economic background.

Moreover, even if rates of return for the next 75 years equal those of the past 75, some workers will, on average, be more likely to experience a substantial loss in benefits than others. For instance, low-wage workers and workers with long average life expectancies will have an even harder time than their higher-earning but shorter-lived counterparts in recovering their loss in retirement benefits through savings in individual accounts (Aaron et al. 2000; Baker 2000).

Currently, Social Security redistributes funds toward low-wage earners, yielding them a higher rate of return on their contributions. While the average worker born between 1956 and 1964 can expect a rate of return of 2.7%, men with low earnings can expect a 4.7% real rate of return and women can expect a 6.8% return (Cohen, Steuerle, and Carasso 2001). Also, as Social Security pays benefits based on lifetime earnings without adjustments for life expectancies, workers who can expect to live longer, particularly women, receive higher lifetime benefits than others. Women born between 1956 and 1964 can expect a real rate of return of 3.7%, compared to 1.7% for men (Cohen, Steuerle, and Carasso 2001).

With individual accounts workers will be on their own, though. It will be harder for lower-wage workers and for workers with longer life expectancies to recover across-the-board benefit cuts with savings in individual accounts. Aaron et al. (2000) estimate that, while a single worker with average earnings who retires in 2037 can recover 63% of the benefit cut with the savings in his or her individual account, a single low-wage worker can recover only 46%.[3]

Because Social Security offers spousal benefits to married couples with only one income earner, while individual accounts do not, married one-earner couples will recover a substantially smaller share of lost benefits than will single workers. Aaron et al. (2000) estimate that a married average-wage worker retiring in 2037 could expect to recover about 39% of the loss in benefits, whereas a married low-wage worker could expect to recover only 30%. Assuming different rates of return on individual accounts, Baker (2000) estimates that a married average-wage worker could recover 28%, and a married low-wage worker 20%, of lost benefits.

The calculations for average-wage workers mask differences between demographic groups. Two factors are of particular importance—life expectancy and earnings. Women, for instance, have a higher rate of return under Social Security than do men because they live longer, thus getting more out of Social Security's guaranteed, inflation proof, lifetime benefit,  and they earn less, thus taking advantage of the more-generous benefits to lower lifetime earners. In other words, in order to receive the same benefits as under Social Security, women would have to have accumulated more relative to their earnings than men to compensate for the fact that they tend to live longer and earn less over their lifetimes.

Moreover, survivorship and disability beneficiaries are likely to recover less in terms of lost benefits than others. If a worker becomes disabled before reaching retirement age, disability benefits are converted to retirement benefits when the disabled worker reaches retirement age. Under a privatized system, workers with a complete working life would have a chance to build up savings to compensate partly for the loss in Social Secu-

**TABLE 1**
**Retirement expenditures by type**
(In millions of dollars)

| Year | Total OASI-DI* expenditures | Total survivors insurance benefit payments | SI share of total OASI-DI expenditures | Total DI benefit payments | DI share of total OASI-DI expenditures | Combined share of total OASI-DI expenditures |
|---|---|---|---|---|---|---|
| 1960 | 11,798 | 2,316 | 20% | 568 | 5% | 24% |
| 1970 | 33,108 | 6,229 | 19 | 3,085 | 9 | 28 |
| 1980 | 123,550 | 26,654 | 22 | 15,515 | 13 | 34 |
| 1990 | 253,135 | 50,745 | 20 | 24,829 | 10 | 30 |
| 2000 | 415,121 | 77,848 | 19 | 54,983 | 13 | 32 |

* Old-Age and Survivors Insurance-Disability Insurance.

Source: *Old-Age and Survivors Insurance Benefit Payments,* http://www.ssa.gov/OACT/STATS/table4a5.html and *Disability Insurance Trust Fund Operations by Calendar Year,* http://www.ssa.gov/OACT/STATS/table4a2.html.

rity retirement benefits. But disabled workers have to rely on the accumulated savings from much shorter working lives. Consequently, disability beneficiaries would experience an above-average benefit cut.

Similarly, if a worker dies, Social Security operates like life insurance and provides benefits to surviving spouses and children. If a worker dies well before retirement age, accumulated individual account balances will be less than they would have been after a full working life, therefore leaving survivors with fewer funds to cover the reduction in benefits.

## Women, children, and African Americans depend on disability and survivorship benefits

To cover the shortfall in income that results from partial privatization, all Social Security benefits—retirement, survivorship, and disability—will likely be cut, and individual account balances are likely to cover only a small portion of the lost benefits. Low-wage workers and women will be particularly hurt by cuts in retirement benefits, but who will be hurt by cuts to survivorship and disability benefits?

Since 1980, disability and survivorship benefits have made up more than 30% of Social Security's expenditures. In 2000, 19% of Social Security's expenditures paid for survivorship benefits to 7 million beneficiaries, while 13% for disability expenditures was allocated to 6.7 million beneficiaries (**Table 1**).

Average disability and survivorship benefits are of about the same amount as average retirement benefits. The average monthly disability benefit was $787 in 2000, about 93% of the average monthly retirement benefit. The average monthly survivorship benefit was $810, or 96% of retirement benefits (**Table 2**).

Women are disproportionately dependent on survivorship benefits because of longer life expectancies and lower lifetime earnings. As noted above, while women constitute 52% of the American population, they constitute 72.3% of survivorship beneficiaries (**Table 3**). For black women, the average monthly survivorship benefit is almost identical (98%) to their average monthly retirement benefit; for white women, the survivorship benefit is about 12% higher than the retirement benefit (Table 2).

African Americans rely more on disability benefits than do whites. While African Americans are 12% of the

**TABLE 2**
**Average monthly benefit by benefit type, race, and gender, 2000**

| Benefit type | Average monthly benefit | White | | | Black | | |
|---|---|---|---|---|---|---|---|
| | | Total | Male | Female | Total | Male | Female |
| Retirement | $844.60 | $859.90 | $970.90 | $739.30 | $724.20 | $795.10 | $659.20 |
| Disability | 787.00 | 809.30 | 915.30 | 666.10 | 731.40 | 790.90 | 662.40 |
| Survivor | 810.20 | 829.90 | 614.90 | 831.40 | 646.00 | 585.80 | 646.90 |

Source: *Social Security Bulletin, Annual Statistical Supplement, 2001.* Note: "Total" figure includes "other" classification and persons of unknown race.

**TABLE 3**
**Characteristics of disability and survivor insurance beneficiaries by race and gender, 2000**

| | Total | White | Black |
|---|---|---|---|
| **Disability insurance (DI) beneficiaries** | | | |
| Men | 2,860,960 | 2,130,480 | 466,520 |
| % of DI beneficiaries | 42.9 | 31.9 | 7.0 |
| Women | 2,339,730 | 1,696,150 | 422,640 |
| % of DI beneficiaries | 35.1 | 25.4 | 6.3 |
| Children | 1,474,590 | 980,200 | 309,300 |
| % of DI beneficiaries | 22.1 | 14.7 | 4.6 |
| Total | 6,675,280 | 4,806,830 | 1,198,460 |
| | 100.0 | 72.0 | 18.0 |
| **Survivors Insurance (SI) beneficiaries** | | | |
| Men | 52,080 | 39,310 | 9,230 |
| % of SI beneficiaries | 0.75 | 0.6 | 0.1 |
| Women | 5,050,980 | 4,435,510 | 478,900 |
| % of SI beneficiaries | 72.3 | 63.5 | 6.9 |
| Children | 1,877,940 | 1,270,430 | 427,570 |
| % of SI beneficiaries | 26.9 | 18.2 | 6.1 |
| Total | 6,985,244 | 5,745,250 | 915,700 |
| | 100 | 82.2 | 13.1 |

Source: Social Security Bulletin, Annual Statistical Supplement 2001.

population, they constitute 18.0% of disability insurance beneficiaries. Moreover, the average monthly disability benefits for African American men and women are almost identical to their retirement benefits.

Finally, the fact that Social Security is a social insurance program designed to help the families of American workers is highlighted by the fact that more than one-fifth of survivorship and more than one-fourth of disability beneficiaries are children. Though just 6% of the U.S. population is under the age of 18, this age group constitutes

22.1% of disability beneficiaries and 26.9% of survivorship beneficiaries. Fifteen percent of the under-18 population is African American, yet they constitute 22.6% of all young survivorship beneficiaries and 20.8% of young disability beneficiaries (from Table 3).

## What the commission may bring

The president's Commission to Strengthen Social Security wants to privatize part of Social Security. Such a radical shift in the program would lower benefit levels and ultimately hurt working people by substantially weakening the insurance protection for low-wage workers, women, children, and African Americans.

The commission's scorched-earth attempt to discredit the nation's immensely successful—and for the most part financially secure—social insurance system is an intellectually dishonest endeavor at best and a raid on public pension funds at worst, since the only sure beneficiaries of a private-account scheme would be the financial firms that collect the fees. Keeping Social Security in the black over the 75-year planning horizon can be achieved through much less radical policy changes, such as raising the income cap for payroll taxes. The Social Security program, not to mention its beneficiaries, is already in good hands. We shouldn't let this commission touch it.

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## Endnotes

1. Unless, of course, payroll taxes are increased in order to raise revenue. But one of the president's principles for strengthening Social Security that underlies the work of the commission is that "Social Security payroll taxes must not be increased."

2. Five members of the 13-member Advisory Council supported the PSA option. Two of them, Fidel Vargas and Caroline Weaver, were named to President Bush's commission (Weaver has since resigned.)

3. This calculation assumes a phased-in benefit cut, rather than an immediate benefit cut of 41% (Aaron et al. 2000). The underlying calculations assume that average rate of return on equities mirrors those of the period 1946-95. Baker (1997) argues that historic rates of return are inconsistent with the low growth projections of the Social Security trustees. Using consistent rates of return would lower the accumulation of savings significantly. Consequently, a single average wage earner retiring in 2037 could expect to recover 41% of lost benefits, whereas a single low-wage earner could recover only 30% (Baker 2000).

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