EPI ISSUE GUIDE

Social Security

EPI Issue Guides are published by:

ECONOMIC POLICY INSTITUTE
1660 L Street, NW
Suite 1200
Washington, DC 20036
(202) 775-8810
http://www.epinet.org

The mission of the Economic Policy Institute is to provide high-quality research and education in order to promote a prosperous, fair, and sustainable economy. The Institute stresses real world analysis and a concern for the living standards of working people, and it makes its findings accessible to the general public, the media, and policy makers.

ECONOMIC POLICY INSTITUTE

EPI ISSUE GUIDE

Social Security

Last updated May 2005

[Jump to General Information on Social Security]

An introduction to Social Security

Social Security is one of America's most important and successful programs, providing over $471 billion in benefits to more than 47 million people in 2003. While Social Security is often considered simply a retirement program, about one-third of its beneficiaries are not retirees. The Social Security system provides three distinct types of benefits for workers and their families: lifetime retirement benefits for retirees who have worked at least ten years, their spouses, and their children; disability insurance for workers, their spouses, and their children; and survivors' insurance for the families of deceased workers. Social Security guarantees working and retired Americans and their families economic stability that keeps them out of poverty.

Social Security benefits are part of a social insurance program and its benefits are distinct from employer-provided pensions, Individual Retirement Accounts (IRAs), or other forms of savings. Retired workers are guaranteed an inflation-indexed payment for their entire lifetime. Other forms of saving have much more risk. For example, an employer pension program may go bankrupt, private investments face substantial risk if there is a market downturn, and workers' savings may run out. The disability insurance provided by Social Security protects workers and their families against a physical or mental disability that renders someone unable to work; the survivors' insurance provides benefits to the families of deceased workers.

The Bush Administration has been making alarming claims that the current Social Security program is "in crisis" and is unsustainable. These exaggerations simply are not true. Estimates by the Social Security trustees (using rather pessimistic assumptions) and the nonpartisan Congressional Budget Office (CBO) indicate that the trust fund is solvent for another 38 to 48 years if we do nothing. In other words, Social Security is not going broke anytime soon. Despite the fact that the Social Security trust fund is as robust today as it has been in recent years, the administration proposes to radically change the Social Security program by cutting benefits while at the same time allowing workers to create individual private accounts. While the exact provisions are not clear, any privatization proposal will not, in and of itself, do anything to ameliorate the shortfall projected in 2042 or 2052.

The administration has said that it considers Model 2 proposed by the President's Commission to Strengthen Social Security a "good blueprint" for reform. That proposal does not "fix" Social Security but instead imposes significant new costs on the existing program coupled with significant cuts in benefits. First, the government will have to borrow trillions of dollars to pay for "transitional" costs since fewer revenues will be available to pay for current beneficiaries. Second, the administration's plan will significantly cut Social Security benefits (even for those who choose not to create a private account)—with the exception of those who are at or near retirement today. For example, the CBO estimates that Model 2 would cut benefits under current law by 45% for average earners retiring in 2065. It is only through benefit cuts that the administration can pretend to address the shortfall that the Bush Administration's Social Security trustees predict when huge payroll tax revenues are diverted into private accounts. Many workers will be unable to make up these benefit cuts with their returns on their private accounts. And women, minorities, and low-income wage earners will be particularly hit by these changes. Finally, beneficiaries of the disability insurance and survivor portions of Social Security will have their benefits cut as well, with no way to close the gap.

The Bush Administration's privatization proposal will not "save" Social Security but will do just the opposite—it will erode a vital social insurance program that provides American workers and their families with a core level of income during retirement, disability, and early death.

General Information on Social Security

Social Security - facts at a glance

Frequently asked questions (FAQ) about Social Security

Frequently asked questions (FAQ) about Social Security Privatization

Key Tables and Charts

- Portion of Social Security benefits payable under existing program
- Changes in trustees' projections over time

Key Publications

Key EPI Publications

President's proposal for deep cuts in middle-income Social Security benefits
By Amy Chasanov and Lee Price, May 2005 (Economic Snapshot)

Social Security's fixable financing issues: Shortfall in funds is not inevitable
By L. Josh Bivens, April 2005 (Issue Brief)

Coming soon to your mailbox: Government misinformation

By Amy Chasanov, March 2005 (EPI Viewpoint)

Social Security Income and the Elderly
By Michael Ettlinger and Jeff Chapman, March 2005 (Issue Brief)

Big deficit, little deficit: The Bush budget and Social Security
By Max B. Sawicky, March 2005 (Economic Snapshot)

Collision course: The Bush budget and Social Security
By Max B. Sawicky, March 2005 (Briefing Paper)

Implications of the Bush budget for people over 55
By Lee Price, March 2005 (Economic Snapshot)

Top earners get Social Security windfall, others get the bill
By William E. Spriggs, March 2005 (Economic Snapshot)

Bush plays down SSA benefits to widows, disabled
By William E. Spriggs, March 2005 (EPI Viewpoint)

Walkmans to iPods: Social Security is better equipped to provide family income protection
By William E. Spriggs, February 2005 (Economic Snapshot)

Removing earnings cap could fix Social Security shortfall
By L. Josh Bivens, February 2005 (Economic Snapshot)

Proposed Social Security price indexing would slash benefits
By Amy Chasanov, February 2005 (Economic Snapshot)

Social Security privatization's motherhood penalty
By William Spriggs, February 2005 (Economic Snapshot)

Privatization fix for Social Security is worse than doing nothing
By Josh Bivens, January 2005 (Economic Snapshot)

Proposal by the president's Social Security commission whittles away at income support
By Lee Price, January 2005 (Economic Snapshot)

Private accounts: The 'spicy sauce' to sell deep benefit cuts
By Lee Price, December 2004 (Economic Snapshot)

Social Security and income

By Josh Bivens, November 2004 (Economic Snapshot)

Related EPI Publications

Health Insurance Coverage in Retirement: The Erosion of Retirement Income Security
By Christian Weller, Jeff Wenger, and Elise Gould, June 2004 (EPI book)

Retirement Made Riskier: House Pension Bill, Treasury Proposal ignore the real problems
By Sarah Harding and Christian Weller, April 2003 (Issue Brief #189)

Retirement Out Of Reach
by Christian Weller, August 2002 (Briefing Paper #129)

Retirement Insecurity: The Income Shortfalls Awaiting the Soon-to-Retire
by Edward N. Wolff, 2002 (EPI Book)

Shortchanging the next generation: Proposed Social Security cut would index benefits to 2006 living standards level, eroding retirement income for everyone thereafter
by Christian Weller, September 2001 (Issue Brief #162)

You're in good hands with Social Security: But privatization proposals would unravel its ability to insure against loss of income, disability, and death
by Christian Weller, July 2001 (Issue Brief #161)

The commission's straw man: Social Security well prepared for retirement of baby boomers in 2016
by Christian Weller, July 2001 (Issue Brief #159)

What the crash means for your retirement
by Christian Weller, May 2001 (Issue Brief #156)

Trust fund's rainy day postponed, again
by Edith Rasell and Christian E. Weller, March 2001 (Issue Brief #152)

The Problems With Privatization
Economic Policy Institute, December 2000 (Social Security Policy Brief)

Social Security and Women
Economic Policy Institute, December 2000 (Social Security Policy Brief)

Social Security: Options for Reform
Economic Policy Institute, December 2000 (Social Security Policy Brief)

Raising the Retirement Age: The wrong direction for Social Security
by Christian Weller, September 2000 (Briefing Paper #98)

The Perils of Privatization: Bush's lethal plan for Social Security
by Edith Rasell and Christian Weller, May 2000 (Issue Brief #145)

Getting better all the time: Social Security's ever-improving future
by Christian Weller and Edith Rasell, March 2000 (Issue Brief #140)

Fixing Social Security: The Clinton plan and its alternatives
by Edith Rasell and Jeff Faux, April 1999 (Briefing Paper #82)

Social Security Isn't Broken: So why does Wall Street want to fix it?
EPI *Paycheck Economics* 1998

The Feldstein-Samwick 'Two Percent Solution': New Social Security Proposal Is Both Inadequate and Risky
by Edith Rasell, November 1998 (Issue Brief #128)

Saving Social Security in Three Steps
by Dean Baker, 1998 (Briefing Paper #79)

Defusing the Baby Boomer Time Bomb: Projections of Income in the 21st Century
by Dean Baker, 1998 (study)

America's Golden Years Ensuring Prosperity in an Aging Society
by Edith Rasell, Max Sawicky, and Dean Baker, 1998 (Issue Brief #125)

The Distributional Effects of Raising the Social Security Retirement Age and Partially Indexing Benefits
by Edward Wolff and Howard Chernick, 1996 (Working Paper #115)

Privatizing Social Security: The Wall Street Fix
by Dean Baker, 1996 (Issue Brief #112)

Robbing the Cradle? A Critical Assessment of Generational Accounting
by Dean Baker, 1995 (study)

Links To Other Organizations

AFL-CIO

American Academy of Actuaries

American Association of Retired Persons and its Research Center

Boston College, Center for Retirement Research

Brookings Institute

Campaign for America's Future

Center on Budget and Policy Priorities

Center for American Progress

Center for Economic and Policy Research

The Century Foundation and its Social Security Network

Congressional Budget Office

Economic Analysis and Research Network

Economic Opportunity Institute (Washington State)

Employee Benefits Research Institute

Institute for Women's Policy Research

Moving Ideas

National Academy of Social Insurance

National Committee to Preserve Social Security and Medicare

Social Security Administration

The Urban Institute

Research by Other Organizations

Why progressive price indexing could lead to the unraveling of Social Security

B Jason Furman, Robert Greenstein, and Gene Sperling, CBPP, April 2005

Pulling a Fast One? The Facts about Social Security

By William E. Spriggs, NAACP Crisis, March/April 2005

Children Get Social Security, Too

by William E. Spriggs, Poverty & Race, March/April 2005

Social Security Accurate Benefit Calculator

Center for Economic and Policy Research (CEPR)

Estimated Social Security benefit levels under President Bush's 2005 individual accounts proposal combined with a proposal to price-index Social Security benefits

Congressional Research Service, March 31, 2005

The life-cycle personal accounts proposal for Social Security: An evaluation

Robert Shiller, March 2005

An analysis of using "progressive price indexing" to set Social Security benefits

Jason Furman of CBPP, March 2005

Defaulting on the Social Security Trust Fund: What It Would Mean, and How It Would Be Done

Dean Baker of CEPR, March 9, 2005

An overview of issues raised by the administration's social security plan

Jason Furman and Bob Greenstein, CBPP, February 7, 2005

Empty promise: The benefit to African American men of private accounts under President Bush's Social Security plan

Dean Baker, CEPR, February 2005

Options to balance Social Security funds over the next 75 years

Virginia Reno and Joni Lavery, National Academy of Social Insurance, February 2005

Estimated OASDI long-range financial effects of several provisions requested by the Social Security Advisory Board-information

Memo from Chris Chaplain and Alice Wade to Stephen Goss, Social Security Administration, February 7, 2005

Thoughts on Social Security Reform
William Dudley, Jan Hatzius, and Edward McKelvey,Goldman Sachs Global Economics Paper No. 120, January 18, 2005

New Details From The President Tonight On Private Accounts Not Likely To Answer Key Questions
Jason Furman, CBPP, February 2005

New Details Indicate Administration Social Security Plan Would Entail Several Trillion Dollars In Borrowing
Jason Furman and Robert Greenstein, CBPP, February 2005

The Administrations Misleading $600 Billion Estimate Of The Cost Of Waiting To Act On Social Security
David Kamin and Richard Kogan, CBPP, February 2005

Social Security, Women, Children and the States
National Women's Law Center, February 2005

President tries to have it both ways: Using misleading numbers about a crisis while advancing a plan that would make matters worse
By Jason Furman, CBPP, February 2005

How the individual accounts in the president's new plan would work
By Jason Furman, CBPP, February 2005

New details indicate administration Social Security plan would entail several trillon dollars in borrowing
By Jason Furman and Robert Greenstein, CBPP, February 2005

Uncharted Waters: Paying Benefits from Individual Accounts in Federal Retirement Policy
Study Panel Final Report, National Academy of Social Insurance, January 2005

Bush's Numbers Racket in *The American Prospect*
Dean Baker, CEPR, January 2005

A Bloody Mess in *The American Prospect*
Norma Cohen, January 2005

Yikes! How to Think About Risk?,
Alicia Munnell, Steven Sass and Maurico Soto, January 2005

Does Social Security Face a Crisis in 2018?,
Jason Furman, CBPP, January 2005

President Portrays Social Security Shortfall as Enormous, but His Tax Cuts and Drug Benefit Will Cost at Least Five Times as Much
Richard Kogan and Robert Greenstein, CBPP, January 2005

Confusions about Social Security in *The Economists' Voice*
Paul Krugman, January 2005

The Social Security Privatization Crisis: Assessing the Impact on African American Families
Maya Rockeymoore of Congressional Black Caucus Foundation, January 2005

So-Called "Price Indexing" Proposal Would Result In Deep Reductions Over Time In Social Security Benefits
By Robert Greenstein, December 2004

Would Borrowing $2 Trillion For Individual Accounts Eliminate $10 Trillion In Social Security Liabilities?
By Jason Furman, William Gale, and Peter Orzsag, December 2004

Should the Budget Rules Be Changed So That Large-Scale Borrowing to Fund Individual Accounts Is Left Out of the Budget?
By Jason Furman, William G. Gale, and Peter R. Orszag, December 2004

Should the Budget Be Changed to Exclude the Cost of Individual Accounts?
By Jason Furman, William G. Gale, and Peter R. Orszag, December 2004

Twelve Reasons Why Privatizing Social Security is a Bad Idea
By Greg Anrig Jr. and Bernard Wasow, December 2004

A Bird's Eye View of the Social Security Debate
By Alicia H. Munnell, December 2004

African Americans and Social Security: Why the Privatization Advocates are Wrong
William Spriggs, November/December 2004

Scare Tactics: Why Social Security Is Not in Crisis
By Bernard Wasow, November 2004

Basic Facts on Social Security and Proposed Benefit Cuts/Privatization
By Dean Baker and David Rosnick, November 2004

Let Us Count the Ways: The Costs of Social Security Privatization are in the Details
By Christian Weller and Jeffrey Wenger, November 2004

Social Security scare campaign
By James K. Gailbraith, August 2004

Social Security: The Largest Source of Income for Both Women and Men in Retirement
Heidi Hartmann and Sunhwa Lee of the Institute for Women's Policy Research (IWPR), April 2003

Gender and Economic in Retirement
Sunhwa Lee and Lois Shaw, IWPR, 2003

The Effect of Using Price Indexation Instead of Wage Indexation in Calculating the Initial Social Security Benefit
By Alison Shelton, Laurel Beedon, and Mitja Ng- Baumhackl, July 2002

The Effect of Using Price Indexation Instead of Wage Indexation in Calculating The Initial Social Security Benefit
Alison Shelton, Laurel Beedon, and Mitja Ng- Baumhackl of AARP, July 2002

Defined Contributions from Workers, Guaranteed Benefits for Bankers: The World Bank's Approach to Social Security Reform
Dean Baker and Debayani Kar, CEPR, July 2002

Reducing Benefits and Subsidizing Individual Accounts,
Peter Diamond and Peter Orszag, June 2002

Reducing Benefits and Subsidizing Individual Accounts: An Analysis of the Plans Proposed by the President's Commission to Strengthen Social Security
By Peter Diamond and Peter Orszag, June 2002

Setting the Record Straight, The Most to Lose: Women and Social Security
Bernard Waslow, April 2002

What Would Really Happen Under Social Security Privatization?
By Greg Anrig Jr. and Bernard Wasow, December 2001

Social Security Helps Reduce Child Poverty
Valerie Rawlston and William Spriggs, 2000

Why Privatizing Social Security Would Hurt Women
Catherine Hill, IWPR, March 2000

Social Security: The Phony Crisis
By Dean Baker and Mark Weisbrot, 1999

Government Research & Resources

Memo to Senate Finance Committee re: Estimated Effect of Price-Indexing Social Security Benefits on the Number of Americans 65 and Older in Poverty
Congressional Research Service, January 2005

Updated Long-term Projections for Social Security
Congressional Budget Office, January 2005

How Pension Financing Affects Returns to Different Generations
Congressional Budget Office, September 2004

Administrative Costs of Private Accounts in Social Security
Congressional Budget Office, March 2004

2004 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds
Social Security Trustees, March 2004

Annual Statistical Supplement, 2003
Social Security Administration, July 2004

Long-Term Analysis of Plan 2 of the President's Commission to Strengthen Social Security
Congressional Budget Office, July 2004

The Outlook for Social Security
Congressional Budget Office, June 2004

Fast Facts & Figures About Social Security
Social Security Administration, 2003

State Statistics, December 2002
Social Security Administration, December 2003

Strengthening Social Security and Creating Personal Wealth for All Americans
The Report of the Presidents Commission, December 2001

Social Security: A Primer
Congressional Budget Office, September 2001

Social Security Privatization: Experiences Abroad

Congressional Budget Office, January 1999

ECONOMIC POLICY INSTITUTE

SOCIAL SECURITY

Facts at a Glance

Last updated May 2005

Facts about Social Security benefits

Social Security has been providing benefits to millions of workers for 65 years.
Social Security—sometimes referred to by its full name, Old-Age, Survivors, and Disability Insurance (OASDI)—is a social insurance system established in 1935 to provide benefits to workers and their family members upon retirement, disability, or death. It is an earned benefit insurance program, which means that only those who work and pay taxes are eligible for Social Security benefits.

At the end of December 2003, Social Security provided monthly benefits to 47 million beneficiaries (or one in every 6 Americans). Social Security paid a total of $471 billion to retired workers, disabled workers, and to the surviving family members of deceased workers in 2001 (SSA 2004 Trustees Report). In 2002, Social Security beneficiaries included about 3 million children under the age of 18.

Social Security benefits are guaranteed to beneficiaries. Because Social Security is not an investment scheme but rather a social insurance program, its benefits will continue to be paid as long as a beneficiary depends on them. Social Security's finances are not subject to the ups and downs of the stock market, or the luck of individual investors. The promise of Social Security benefits is instead backed by the good faith of the U.S. government, pretty much in the same way that the government backs the value of the dollar. Thus, there is no uncertainty for beneficiaries—once they start receiving benefits, they will continue to receive them in the future.

Social Security offers mainly retirement benefits.
Workers can receive four different types of benefits under Social Security: retirement, early retirement, disability, and survivorship benefits.

Workers are entitled to retirement benefits if they have contributed to Social Security for at least 10 years, and if they have reached the normal retirement age, which is currently 65 (and is set to increase to 67 for workers born after 1959).

Early retirement benefits are available to workers if they have contributed to Social Security for at least 10 years, and if they have reached the earliest age at which benefits can be paid, currently 62. Benefits, however, are reduced by 20% compared to what the retiree would have received at age 65.

Both full and early retirement benefits were paid to 29.2 million retired workers in 2002. Of these, 71% or 20.8 million retirees received a reduced benefit payment because they chose the early retirement option. Average monthly retirement benefits for all workers receiving retirement benefits were $895 in 2002, or about $10,700 per year. In comparison, workers who had retired early received on average $830 per month.

Workers are also insured in case they become disabled.

Social Security provides insurance to workers in case they become disabled and can no longer work. The disability need not be related to an accident at the worker's job. The number of years that are required to receive disability benefits varies with the age of a worker. Younger workers need fewer years to qualify for disability benefits. In 2002, Social Security paid an average monthly disability benefit of $834 to 5.5 million beneficiaries.

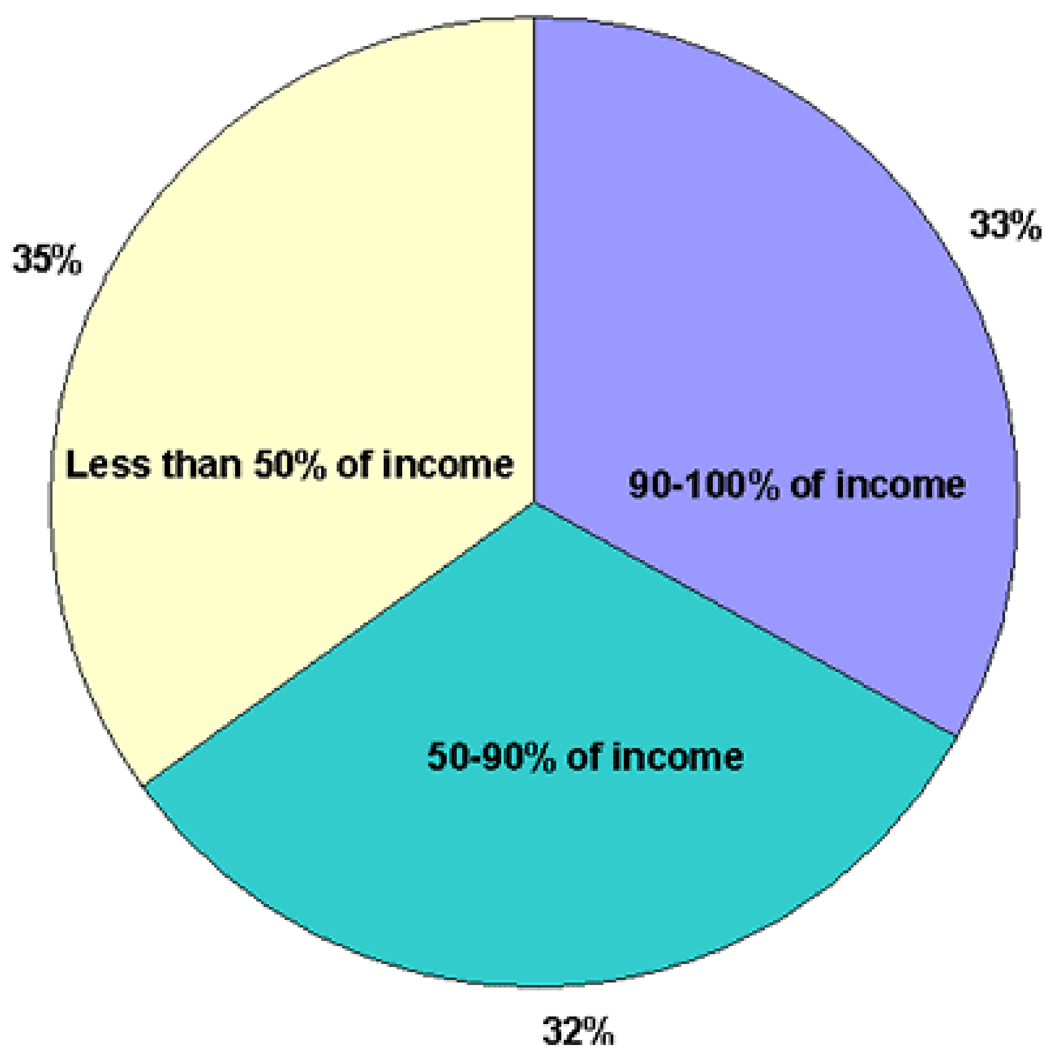
Social Security offers life-insurance type benefits to workers.

If a worker dies, her family receives benefits from Social Security. Survivorship benefits are paid if the deceased worker has, on average, worked at least one quarter for each year after he or she attained the age of 21. In 2002, Social Security paid an average monthly survivorship benefit of $861.

Social Security is the most significant source of income for the majority of retirees over 65 years old.

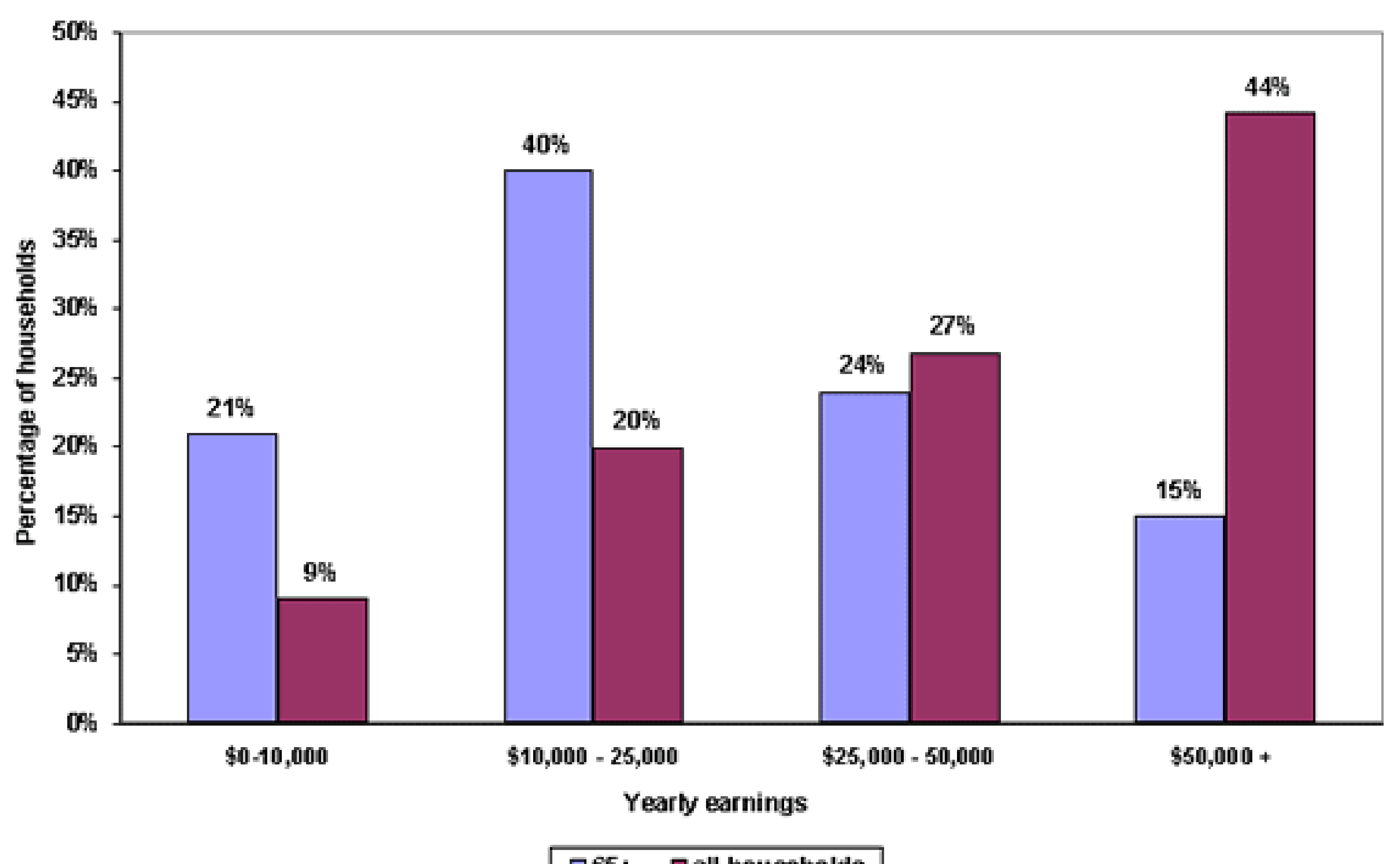
Social Security benefits are the most important source of income for the majority of elderly households. Although these benefits are modest, they account for a large portion of income for many elderly households.

Figure 1 presents a summary of data collected by the Social Security Administration (SSA) from 2001. The SSA found that Social Security provided more than half of the total income for almost two-thirds of households comprised exclusively of those aged 65 and older and provided at least 90% of income for a third of this group.



Social Security is a successful anti-poverty program for workers 65 and older.

Because Social Security is an insurance program, it includes a number of features that redistribute income to ensure that everybody receives adequate benefits. While Social Security benefits provide the lion's share of income for most Americans aged 65 and over, their incomes remain far below those of the general population. **Figure 2** compares data on 65-and-older households from the SSA with data on all household incomes from the Census Bureau, showing the percentage of households that fall within certain income bands. Twenty-one percent of 65-and-over households earn less than $10,000 in total money income annually, compared to 9% of all households. On the upper-end of the distribution, only 15% of 65-and-older households earn more than $50,000, compared to 44% of all households.



Social Security is a social insurance program.

Social Security replaces the source of income a worker has lost due to retirement or disability, or the income a family has lost due to the worker's death. To ensure that Social Security benefits are adequate for every worker who is insured, Social Security—like any other insurance—pays disproportionately more benefits to those who need them most. Workers with low lifetime earnings receive relatively higher benefits (in relation to their lifetime earnings) than workers with high lifetime earnings. The retirement benefit received by a low earner is smaller in absolute terms, but larger as share of earnings, than the benefits received by high earning workers. For example, typical low-wage workers will receive annual benefits that are more than half as large (57%) as their average yearly earnings. Benefits for high-wage workers are larger but on average just 38% of their annual earnings. This progressive benefit structure boosts the retirement incomes of low- and middle-wage workers.

Social Security also provides higher lifetime benefits to workers who live longer. By the time a worker retires, benefits are granted on the basis of a workers age and earnings history. Because women have significantly higher life expectancies than men, they will receive the same monthly Social Security benefits than men.

Social Security is particularly important to women.

Women have fewer earnings to rely on in retirement. Less than half of all workers (46%) had a private pension through their employer in 2002, women are less likely than men: 44% of women have pensions compared to 47% of men. Women of color are even less likely to have a pension than are white women. Furthermore, a woman's pension is typically smaller than a man's because women earn less per hour, and often work part time or spend time out of the labor force. Because they earn less, women have fewer savings than men to depend upon in retirement—thus they rely more heavily on Social Security.

Since women live in retirement an average of three and a half years more than men, they need more retirement income over the course of their lives, not less. They need a retirement program - like Social Security - that provides more income to people who live longer.

Given their longer life spans, it is especially important for women that Social Security benefits be adjusted each year for inflation. If inflation were 3% per year but benefits were not adjusted accordingly, benefits would buy 25% less after 10 years and 45% less after 20 years.

A woman who never worked but stayed home to care for family is still entitled to a Social Security benefit equal to half that of her working husband.

Widows and divorced women (after a marriage of at least 10 years) are entitled to Social Security benefits even if they never worked, so long as their husbands were eligible for benefits.

Facts about Social Security finances

To pay for benefits, Social Security receives income from three sources.

Most of the money that is needed to pay for benefits comes from payroll taxes. Currently, employees and employer each pay 6.2% to Social Security, for a combined tax rate of 12.4% of wages and salaries. Self-employed workers pay the full 12.4% out of their earnings. Taxes, however, have to be paid only up to an earnings ceiling, which is $90,000 annually in 2005. Earnings above the ceiling are not subject to the payroll tax. In 2003, Social Security received a total of $535.2 billion in payroll taxes.

As a result of reforms to Social Security in 1983, a trust fund was specifically set up as a savings account to pay for baby boomers. Since then, Social Security has taken in more money than it has paid out in benefits. Consequently, it has built up a trust fund over the years. Social Security earns interest on this trust fund. In 2003, the Old Age and Survivor's Insurance trust fund received 6.0% interest on its assets, earning $75.2 billion in interest, and the Disability Insurance trust fund received 5.9% interest, earning $9.7 billion in interest.

Finally, some Social Security benefits are subject to taxes, which are then paid to Social Security. In 2003, taxes on Social Security benefits amounted to a total of $13.4 billion.

Social Security is building up a trust fund.

Because income is currently exceeding expenditures, Social Security is building up a trust fund. Total income to Social Security was $632 billion in 2003. Its expenditures came to $479 billion, $471 billion of

which was benefit payments. Consequently, Social Security managed to increase its trust fund by $153 billion in 2003. As a result, Social Security held a total of $1,531 billion in assets at the end of 2003. If Social Security faces a shortfall in income, the trust fund assets can be used to pay for the additional benefits.

Trust fund assets are invested in government bonds.

Social Security trust fund assets, currently worth over $1.5 trillion, are invested in special, non-tradable government bonds. Each year the U.S. Treasury issues these government bonds, up to the amount of the Social Security trust fund surplus, to be added to the account. The bonds earn an interest rate comparable to the market interest rate for tradable government bonds. During 2003, the effective annual interest rate earned on all bonds held by the trust funds was roughly 6.0%.

Social Security is not going broke.

Each year, in early spring, the trustees of Social Security release their report. As required by law, the trustees present what can be described as their best guesses for three different scenarios for the future of Social Security. In their annual report for 2004, the trustees project that Social Security will take in more in income than it will pay out in expenditures until 2018. Between 2018 and 2028, interest income earned on the trust fund assets is forecasted to make up the difference between income and expenditures. After 2028, Social Security is expected to draw down its trust funds to pay for the expenditures that are not covered by income. Finally, in 2042, the trust fund assets are expected to be gone, and income is projected to be less than expenditures. However, the trustees project that Social Security will still be able to pay 74% of its promised benefits from 2042 to 2078, and those benefits would still be higher in real (inflation-adjusted) terms than retirees are being paid today.

Social Security is not going broke. The trustees instead project a financing shortfall that may happen almost 40 years from now. The nonpartisan Congressional Budget Office doesn't project a shortfall until 2052. The trustees' projections are based on pessimistic assumptions. Real growth is expected to fall to between 1.7% and 1.8% over the long-run, which has never been the case for an extended period of time during the post-war years. Similarly, the trustees assume that in the long-run the economy will settle on an average productivity growth rate of 1.6%, which is again too low by historical standards. Higher productivity and consequently faster real wage growth—which have both historically been about 2.0%—would be more realistic and improve Social Security's finances.

Sources:

Century Foundation. 1998. *Social Security Reform: A Twentieth Century Fund Guide to the Issues,* New York, N.Y.: Century Foundation.

Mishel, Lawrence et al. 2004. The State of Working America, 2004/2005, Washington, D.C.: Economic Policy Institute.

Social Security Administration. 2003. *Annual Statistical Supplement to the Social Security Bulletin.* Washington, D.C.: Social Security Administration.

Social Security Administration, 2004, *The 2004 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds*, Washington, D.C.: Social Security Administration.

Social Security Administration. 2002. *Income of the Population 55 or Older*. Washington, D.C.: Social Security Administration.

ECONOMIC POLICY INSTITUTE

SOCIAL SECURITY

Frequently Asked Questions

Last updated May 2005

Frequently asked questions about Social Security

Who gets Social Security benefits?

Social Security provides retirement benefits to workers, their spouses, and their dependents, survivorship benefits to family members of workers who have died, and disability benefits to workers who become disabled before retirement. Workers are eligible for retirement and disability after they have contributed for a certain time. To be eligible for retirement benefits, for instance, a worker needs to contribute for 10 years. Also, the surviving spouse and children of a worker are eligible for survivorship benefits if a worker dies. The time necessary to reach eligibility for any of the benefits varies from benefit to benefit.

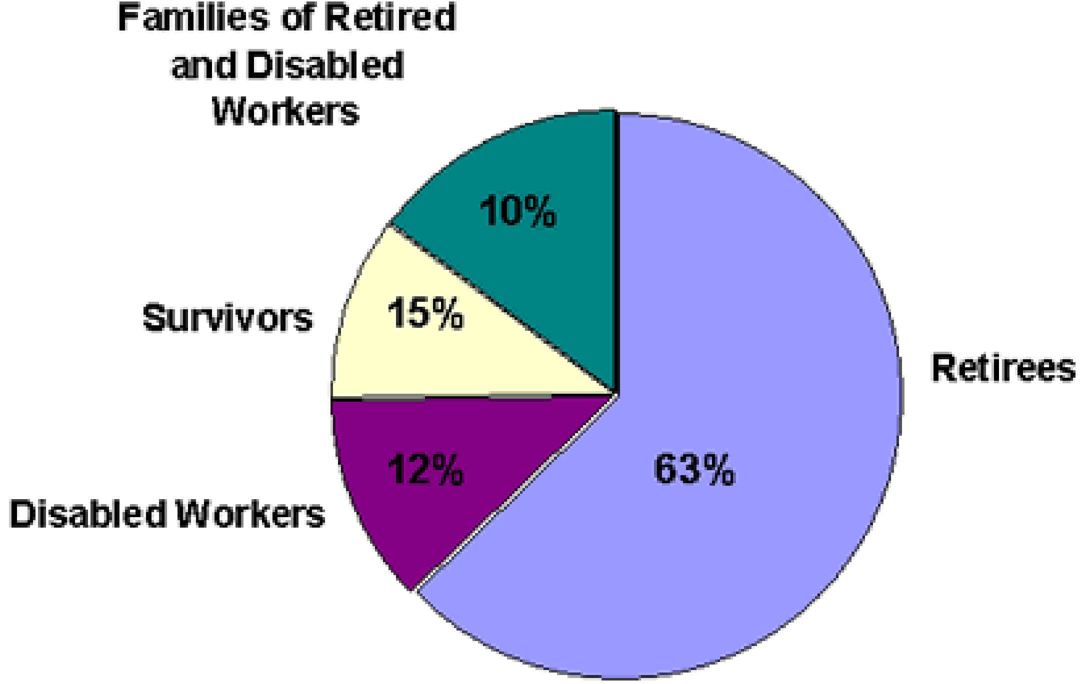
What types of benefits does Social Security offer?

Retirement benefits are guaranteed monthly benefits that increase each year at the rate of inflation and are paid for the worker's entire life. Social Security also provides disability and survivorship benefits.

Contributions to Social Security are based on a worker's earnings. Consequently, any benefit from Social Security depends on the number of years a worker has contributed to the program and on the earnings during those years.

Workers are entitled to their full retirement benefits once they reach the normal retirement age (NRA). Additional benefits can be paid for spouses if their own benefits would be lower than 50% of the worker's retirement benefits. Furthermore, a worker can receive additional benefits for dependents, such as children or elderly parents. In 2002, 29.2 million retirees received Social Security benefits and 3.2 million spouses and children of retirees received benefits.

Disability benefits are payable to workers who are no longer able to work due to a physical or mental impairment. In 2002, 5.5 million disabled workers received Social Security benefits and 1.7 million spouses and children of disabled workers received benefits. Also, survivorship benefits are paid to a surviving spouse and dependent children upon a worker's death. In 2002, 6.9 million individuals received survivor benefits. **Figure 3** shows that less than two-thirds of Social Security beneficiaries are actually retirees.



What determines the level of Social Security benefits?

Social Security offers basic benefits that allow retired workers, disabled workers, or the survivors of deceased workers to have sufficient income to stay out of poverty.

The average level of benefits varies according to a worker's earnings history. Since women tend to have lower lifetime earnings than men, their average benefit levels are also lower. For instance, in 2002, the average monthly retirement benefit for men was $1,008.10, while the average monthly retirement benefit for women was $773.90. Similarly, African American workers tend to have lower life time earnings than whites, which results in lower average benefits. African Americans received average monthly retirement benefits of $774.80, whereas white retirees received, on average, $911.70 a month.

Social Security benefits are progressive because it is an insurance program. In providing retirement and life insurance, Social Security redistributes income from high lifetime earners to low lifetime earners. A few hypothetical cases—taken from the 2002 trustees' report—illustrate Social Security's redistribution process. A worker who earned average wages over his or her career and retired at age 65 in 2005 will receive annual Social Security benefits equal to 45% of his or her average annual earnings. Social Security would replace 57% of the average annual earnings of a low-earning worker (who earned 50% of the average earnings), and 38% of the average annual earnings of a high-earnings worker (who earned 50% more than average). So, while high-earning workers receive more money in their Social Security

checks, they receive a smaller portion of their earnings.

Is Social Security going broke?

Social Security is not going broke. In fact, even under the pessimistic assumptions of the Social Security trustees, Social Security can pay full benefits until the year 2042. Thereafter, Social Security can still pay more than two thirds of its promised benefits.

Social Security is a successful government program that is not facing an immediate crisis or an explosion of costs that put an unbearable burden on society. Instead, Social Security may face a financing shortfall after 2042 if the pessimistic assumptions of Social Security's trustees turn into reality (or after 2052 based on the Congressional Budget Office's current predictions). Should this be the case, a number of options are available to pay for the shortfall, such as tax increases, new government debt issues, or benefit cuts. Ultimately, it is a policy decision as to how we want to pay for Social Security, not an economic inevitability that requires us to give up on the program.

What does Social Security's future look like?

Each year, in early spring, the trustees of Social Security release their report. As required by law, the trustees present what can be described as their best guesses for three different scenarios for the future of Social Security. In their annual report for 2004, the trustees project that Social Security will take in more in income than it will pay out in expenditures until 2018. Between 2018 and 2028, interest income earned on the trust fund assets is forecasted to make up the difference between income and expenditures. After 2028, Social Security is expected to draw down its trust funds to pay for the expenditures that are not covered by income. Finally, in 2042, the trust fund surplus is expected to be depleted, and annual revenue into the program is projected to be less than expenditures. However, the trustees project that Social Security will still be able to pay for more than two-thirds of its promised benefits from 2042 to 2078.

What are the trust funds?

Social Security has two trust funds. One trust fund is for the retirement and survivorship parts of the program, the other is for the disability part. Since 1983, Social Security has been building up its trust funds in anticipation of the baby boomers' retirement. Once baby boomer retirement is in full swing, Social Security will begin to draw on these nest eggs to pay for parts of the benefits that are promised to the baby boom generation.

How much money is in the trust funds?

Because income is currently exceeding expenditures, Social Security is accumulating assets in its trust funds. By the end of 2002, Social Security held over $1.5 trillion in assets.

Even though the total amount of trust fund assets seems very large in absolute terms, it is not very large relative to the size of the program. In particular, the assets of the trust fund cover a little over two years worth of expenditures for Social Security. Put differently, if Social Security suddenly had no income, it could still cover all beneficiaries for the next two years by dipping into its savings.

In what assets do Social Security trust funds invest?

Social Security trust fund assets, currently worth over $1.5 trillion, are invested in special non-tradable government bonds. This investment allocation has been chosen because government securities, such as treasury bonds are the safest form of financial investment.

The bonds held by Social Security earn an interest rate comparable to the market interest rate for tradable government bonds. During 2001, the effective annual interest rate earned on all bonds held by the OASI trust funds was 6% and it was 5.9% for the DI trust funds.

Sources:

Baker, Dean. 1997. *Saving Social Security with Stocks: The Promises Don't Add Up.* New York, N.Y.: The Twentieth Century Fund.

Baker, Dean. 1998. *The Full Returns from Social Security,* A Century Foundation/Economic Policy Institute report. New York, N.Y.: The Century Foundation.

Baker, Dean, and Mark Weisbrot. 1999. *Social Security: The Phony Crisis.* Chicago, Il.: University of Chicago Press.

Century Foundation. 1998. *Social Security Reform: A Twentieth Century Fund Guide to the Issues,* New York, N.Y.: Century Foundation.

Rosnick, David. 2004. Center for Economic and Policy Research analysis of the 2004 Social Security Trustees Report.

Social Security Administration. 2004. *The 2004 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds.* Washington, D.C.: Social Security Administration.

Social Security Administration. 2004. *Annual Statistical Supplement to the Social Security Bulletin.* Washington, D.C.: Social Security Administration.

ECONOMIC POLICY INSTITUTE

SOCIAL SECURITY

Frequently Asked Questions

Last updated May 2005

Frequently asked questions about Social Security privatization

Private accounts: What they are and what they aren't.

- What is Social Security "privatization"?
- Aren't people better off with 401(k)s than Social Security benefits?
- Will workers really "own" their private accounts?
- Will workers be forced to invest in companies whose activities they find morally repugnant?

Social Security is not in crisis, but does face funding challenges over the long term.

- How long will Social Security be able to pay 100% of scheduled benefits?
- Isn't the Social Security trust fund just an "accounting fiction?"
- Is the long-term Social Security shortfall $4.0 trillion or $11.1 trillion?
- Have projections regarding the health of the Social Security trust fund changed over time?
- Given that the current Social Security program is expected to fully fund scheduled benefits for the next 36 to 47 years, is Social Security really in crisis?
- Can private accounts solve the long-term shortfall in the Social Security trust fund?

Deep Social Security benefit cuts will accompany any privatization effort.

- How will current Social Security benefits be cut under privatization?
- What is the difference between "wage indexing" and "price indexing"?
- How much will workers get charged for diverting funds into private accounts?

The government will have to borrow trillions to fund private accounts.

- In addition to benefit cuts, what other costs are associated with privatization?
- What transition costs are associated with privatization?
- Is borrowing $4.9 trillion for transition costs really a savings?
- Will the additional costs of privatization negatively affect the overall economy?

The administrative costs to fund private accounts may be huge.

What administrative costs are associated with Social Security privatization?

Americans will be worse off under privatization.

Won't most retirees be better off under privatization?
What will be the likely effect of the President's plan to price index benefits and create private accounts?

Privatization proponents have misled many groups into thinking they're better off under privatization.

How are survivors and disabled workers and their families treated under privatization?
Are high and low income workers helped equally by private accounts?
Won't privatization help African Americans because their shorter lives mean they draw Social Security for fewer years?
Are women and men helped equally by private accounts?
Are younger workers better off with private accounts?

Privatization efforts abroad raise a red flag.

What can we learn from the experience of other countries after they privatized their Social Security programs?

Unlike privatization, there are alternatives that would address the long-term funding crisis.

Can Social Security be reformed without substantial benefit cuts?

Private accounts: What they are and what they aren't.

What is Social Security "privatization"?

Social Security is "social" in the sense that, because it is a virtually universal program, Americans share the risks of paying for disability, untimely death, and low earnings in old age. A "privatized" system pushes the risks onto the individual. The current Social Security system is "secure" because it uses a set benefit formula to insure a level of benefits relative to a worker's earnings history. In contrast, a privatized system shifts the risk onto individuals that their level of benefits might be inadequate relative to their earnings history or that they may begin drawing on benefits at a bad time for stock or bond markets.

When the Bush Administration and others talk about "privatizing" Social Security, they mean diverting some portion of Social Security payroll taxes into individual private accounts that will be used to save for retirement. Currently, 12.4% of all wages, up to $90,000, are subject to a payroll tax. Employees contribute half that amount (6.2%) and employers contribute the other half. Under a privatization plan,

wage earners could choose to have some of their payroll taxes placed directly into a private account and make decisions about how to invest those funds. The remainder of their payroll taxes will either be used to pay benefits to current beneficiaries or else deposited into the Social Security trust fund.

No plan has been proposed yet, and it's still unclear whether the Bush Administration will propose a specific plan or leave the details up to Congress. The Bush Administration has indicated that Plan 2 proposed by the President's Commission to Strengthen Social Security provides a good blueprint for privatization. (President's Commission, Strengthening Social Security and Creating Personal Wealth for all Americans, December 2001). Under Plan 2, workers under 55 years of age could voluntarily reallocate up to 4% of their payroll taxes (i.e., two-thirds of their employee contribution), up to $1,000 annually, into a private account. Workers initially earning over $25,000 who contributed the maximum percentage would therefore hit the $1,000 cap. According to a White House document on Social Security, the $1,000 cap would be increased by $100 a year until at least 2015 (but perhaps indefinitely), and would also be indexed annually with national average wage growth. (See White House, Strengthening Social Security for the 21st Century, February 2005). The ultimate proposal may allow a higher or lower percentage to be diverted and may have a higher annual cap, but is likely to be "partial" in that it will not allow 100% of payroll taxes to be diverted into a private account.

Any new system of private accounts would not improve the long-term balance in the Social Security trust fund, and, in fact, would put new stresses on the existing system. Strengthening Social Security requires either increasing the revenues going into the trust fund or lowering the benefits paid from the trust fund. Because President Bush directed the Commission not to consider revenue increases, the Commission's privatization proposals make the Social Security trust fund more solvent only through benefit cuts to retirees, disabled workers, and the survivors of deceased workers.

[back to top]

Aren't people better off with 401(k)s than Social Security benefits?

401(k)s are retirement saving vehicles. This makes them less comprehensive than Social Security, which also includes family benefits in the event of disability and untimely death. (See Bill Spriggs, Walkmans to iPods: Social Security is better equipped to provide family income protection, February 2005). Social Security is an important social insurance program that the government is in a unique position to provide. Right now, for those workers getting the old-age benefit, the Social Security system provides benefits no government Thrift Savings Plan (TSP) or 401(k) can match: an inflation-indexed annuity, life insurance, and disability insurance. The government serves as a universal insurer by investing in low-risk assets (government bonds), spreading the cost of the program over generations. Therefore, Social Security's guaranteed benefit does not depend upon the outcome of the stock market and is not tied to the decisions of individual investors. Rather, Social Security automatically adjusts the benefit to reflect a worker's earnings history, which insures a worker against underestimating her earning ability. Social Security also follows workers from job to job, and, unlike a private fund, is not affected by breaks in payments from times when workers are unemployed.

Private accounts lack the important social insurance properties of Social Security. Social Security adjusts for inflation; is guaranteed to last an entire lifetime, no matter how long; is shielded from stock market losses; and, when younger workers become disabled or die, provides substantial income replacement to multiple beneficiaries across generations (e.g., to surviving family members for their lifetime). Private accounts and 401(k)s have none of these protections. Workers investing in private accounts will take on risks that are currently covered by Social Security protections.

In essence, then, private accounts would fundamentally shift the risk from the government to individuals, changing the Social Security program into an "Individual Insecurity" program. The Bush Administration understands that it is asking Americans to shoulder a substantial amount of new risk, but claims this is part of its concept of an "ownership society": "We have it within our grasp to move away from dependency on government and toward giving greater power and responsibility to individuals." (January 3, 2005 White House email, which describes why the administration wants to enact Social Security privatization). However, rather than just shifting ownership of retirement assets from the government to workers as the Bush Administration claims, Social Security privatization shifts an inordinate amount of risk away from the government and onto American workers.

At the same time, the new private accounts would have less flexibility and more risk than 401(k) accounts, according to White House description. (See White House, Strengthening Social Security for the 21st Century, February 2005). Once an individual opted to have a private account, they would be locked into the system for the rest of their lives. They would be charged for the money put into the account at a variable rate between the time the money is put in until the time it is withdrawn and an interest rate equal to inflation plus 3%.

Individuals would face a number of new risks that are uniquely associated with private accounts and which they do not face with Social Security today:

- ***Investment risk.*** The President's Commission and other privatization proponents have exaggerated the average rate of return on private accounts and incorrectly assumed that all investors can achieve that average return. While it is true that stocks have historically outperformed government bonds over the long run, this higher return is accompanied by much higher risk. For example, in any given 10-year period over the last 75 years, investors had a 25% chance of realizing lower returns from a stock portfolio than from government bonds. (Alicia Munnell, Steven Sass and Maurico Soto, Yikes! How to Think About Risk?, January 2005). The United States' experience with 401(k) plans to date shows that many people fail to understand even the most basic aspects of investment and that many make bad investment decisions (e.g., failing to diversity their investments). Unfortunately, many people simply do not have adequate financial experience, training, or time to do a good job managing their own accounts. (Alicia Munnell, We've Already Tried Private Accounts! in *The American Prospect*, January 2005; Reason #5 in Greg Anrig Jr. and Bernard Wasow, Twelve Reasons Why Privatizing Social Security is a Bad Idea, December 2004). There's also new research that indicates a wide array of choices—particularly in voluntary 401(k) accounts—isn't necessarily a good thing. The more investment options people have, the less able they are to make a choice, and there's actually a significant decrease in 401(k) participation when

more funds are offered. (Barry Schwartz, Choose and Lose, in *The New York Times* January 5, 2005).

- ***Investment-related timing risk.*** Most of us know the simple stock market advice: "buy low, sell high." Workers with private accounts may reach retirement and be faced with just the opposite investment reality. Even if the stock market outperforms Treasury securities in the long term, if the market is at a downturn when a worker retires and needs to convert his money into an annuity, that worker will be forced to choose between taking a significant loss or waiting for the market to swing back up again before retiring. (For a graph on how historical replacement rates have changed wildly based on when a worker retires, see Reason #6 in Greg Anrig Jr. and Bernard Wasow, Twelve Reasons Why Privatizing Social Security is a Bad Idea, December 2004). The White House has indicated that there would be a "life cycle portfolio" investment option which automatically shifts the investments away from stocks and more into bonds as the worker nears retirement age. All private accounts would be assigned to this life cycle portfolio when a worker turns 47. (See White House, Strengthening Social Security for the 21st Century, February 2005). In order to opt out of the life cycle account, the worker and his or her spouse would have to sign a form acknowledging the risks involved. Economist Robert Shiller recently analyzed historical stock returns and economists' predictions and finds that under a realistic estimate of return, 71% of workers opting for personal accounts in life-cycle portfolios would earn less in benefits than those who remain under the traditional Social Security system. (See Robert Shiller, The life-cycle personal accounts proposal for Social Security: An evaluation, March 2005). Thus, life cycle accounts may not ameliorate timing and investment risk. Moreover, they would almost certainly diminish workers' potential return on their accounts, particularly when the accounts are initially phased in for 40 and 50 year-old workers. In addition, workers would invest the least just when stock prices are lowest and it is the best time to buy, because stock prices tend to be low during recessions when workers are more likely to be laid off or have lower earnings. (Christian Weller and Jeffrey Wenger, Let Us Count the Ways: The Costs of Social Security Privatization are in the Details, November 2004).

- ***Health-related risks.*** Currently, the Social Security system compensates workers no matter what their health status or longevity. For example, workers who become disabled and are no longer able to work are covered under the Social Security system. On the other hand, retirees are paid benefits even when they live to a very old age. Privatization shifts the risk of both bad health and long life onto workers and away from the government. A worker's lifetime earnings can be reduced by her own bad health or by taking time off to care for another family member. Disabled workers and the families of workers who die young would be much worse off under privatization because the worker would not have adequate time to build up his or her private account sufficiently to offset the cuts in traditional Social Security benefits. Similarly, those who live a long life risk running out of money in their private account if it is not converted to a lifelong annuity.

- ***Inflation risk.*** The White House has proposed that people would be charged an interest rate of inflation plus 3% for the federal borrowing necessary to create private accounts. Historically, spurts of inflation have hurt both bond and stock returns. If that occurs in the future, then more inflation would hit individuals with private accounts with higher interest charges just when bond and stock returns are low. In addition, under all three privatization plans recommended by the President's Commission, retirees are expected to convert their private account into an annuity that

will make monthly payments to them for their lifetime. If the annuity does not provide inflation-protection, the purchasing power of the monthly payments will decline over time. The conversion of a private account into an inflation-adjusted annuity, however, might be expensive and therefore require a substantial reduction in monthly benefits at the outset.

[back to top]

Will workers really "own" their private accounts?

These private accounts are part of the Bush Administration's effort to promote an "ownership society." (January 3, 2005 White House email). In reality, there will be serious restraints on what workers will be able to do with these new accounts. While workers will have some investment alternatives, the White House has said the options would be similar to the five plans currently under the Thrift Savings Plan (i.e., a large cap stock fund, a small cap stock fund, an international stock fund, an investment-grade corporate bond fund, and a government securities fund). (See White House, Strengthening Social Security for the 21st Century, February 2005). Workers will either face a very limited number of investment options, or else there will be large administrative costs that will take a substantial bite out of the returns earned in a worker's private account. Supporters of privatization have argued that they can keep administrative costs low by offering only a few choices. But, any increase in the number of investment options will be coupled with increased administrative costs and greater stock return risk. Investment options with higher average expected returns than U.S. Treasuries have a higher risk of low or negative returns for extended periods.

Plan 2 assumes important restrictions on "ownership." Today, many people have IRAs, 401(k) plans, and other personal savings and are able to take that money out prior to retirement for a host of reasons. While Plan 2's private accounts will be linked to individual workers, the Commission and the President have made clear that workers would not be allowed to withdraw their money before retirement. (See White House, Strengthening Social Security for the 21st Century, February 2005). If political pressures build, as they have for tax-advantaged retirement savings accounts, the restrictions may be relaxed to permit workers to withdraw money before retirement-to buy a home, pay medical expenses, or invest in education. If this happens—as it has on a widespread basis in IRAs and 401(k)s—the foundation of a worker's retirement savings will be eroded in a way that it cannot under the current system. The White House plans to impose another limitation: once a worker opts into a private account, they could never opt-out. (See White House, Strengthening Social Security for the 21st Century, February 2005).

Plan 2 also imposes limitations on how the accounts can be withdrawn. Plan 2 assumes workers will be able to bequeath their private account to their heirs. White House plans indicate that workers would be required to withdraw enough money from their account to ensure they are living at the poverty line. (See White House, Strengthening Social Security for the 21st Century, February 2005). Workers living at or near poverty with their benefits will not have sufficient funds to pass to their heirs. Workers with sufficient income above the poverty line will have to choose between purchasing an annuity adequate to support them in their retirement or saving their private account to bequeath to their heirs. Either way, many workers either won't have any money left to pass on or else will sacrifice their well-being in their later years.

Under the current system, workers own something more valuable than a private account; they own an insurance policy that protects them and their family members against the costs of disability, death and old age. The payroll taxes a worker puts into the Social Security system today are the "premiums" for the social insurance that Social Security provides; they are not deposits into a personal pension plan. Most of the current payroll taxes go to pay current beneficiaries and the excess is put into a trust fund for future beneficiaries, not into an account for that particular worker to collect upon retirement. To carve a pension plan out of this important social insurance scheme fundamentally undermines the very nature of Social Security.

[back to top]

Will workers be forced to invest in companies whose activities they find morally repugnant?

The Bush Administration has said that the government should not invest the Social Security trust fund in stocks because workers paying into the system may not approve of the funds the government chooses. In other words, the fund choices available may contain the stocks of companies whose activities a worker opposes. For example, the company may be environmentally unfriendly, sell tobacco or alcohol products, or engage in some other type of activity that is morally repugnant to the worker. The judgment over what types of activities are morally repugnant obviously varies considerably among individuals, and it will be difficult to assemble a diversified portfolio of companies that does not offend at least some investors.

Private accounts cannot solve this dilemma without offering a wide array of investment funds, each selecting stocks with different criteria. But such a wide array would have two negative effects on returns. First, it would impose very large administrative costs to assure that the standards for corporate behavior are met. Second, there is likely to be a smaller number of approved corporations, which would increase the risk of substantial losses in some funds because the funds will include a narrower range of corporations.

Investment in a widely diversified portfolio with low administrative costs will require purchases of stock in some companies that offend some people, whether the investment is done by the Social Security trust fund or by a limited number of funds available to private account holders. Therefore, a worker's ownership and control over a private account will be hindered because the limited fund options available for investing may not reflect her personal beliefs.

[back to top]

Social Security is not in crisis, but does face funding challenges over the long term.

How long will Social Security be able to pay 100% of scheduled benefits?

Social Security has two dedicated trust funds-one for the Old Age and Survivor Insurance programs (OASI) and another for the Disability Insurance program (DI). Until 1983, Social Security operated on a

pay-as-you-go basis (that is, taxes paid into the system were used to pay benefits and not to build up a surplus). A 1983 bipartisan agreement revised the program so that it would generate surpluses for several decades. The surpluses are needed to build up a trust fund because outlays are expected to increase substantially as the baby-boomer generation retires in large numbers and Americans continue to live longer. The trust fund balance is almost $1.7 trillion and is currently running a surplus, with 75% of the money collected (including interest and taxation of benefits) paid out as benefits. Most of the remaining money goes into the Social Security trust funds and is invested in government bonds.

The Social Security Board of Trustees—which includes the Secretaries of Treasury, Labor, and Health and Human Services—is responsible for reporting the current and projected financial condition of the Social Security program each year. According to the trustees' "intermediate" scenario, the Social Security trust fund currently has enough money to pay 100% of scheduled benefits for the next 36 years, until 2041. (Social Security Trustees, The 2005 Annual Report of the Board of Trustees, March 23, 2005). Assuming there are no changes to the Social Security system—no tax increases and no benefit cuts—there will not be a shortfall for about four decades. Under the trustees' projections, in 2041, the payroll taxes coming in would still be sufficient to pay retirees about 74% of their scheduled benefits. Importantly, those benefits would still be much higher in real (inflation-adjusted) terms than what retirees are being paid today. (Josh Bivens of EPI, Privatization fix for Social Security is worse than doing nothing, January 26, 2005). Under the trustees' more optimistic ("low-cost") scenario, there's no shortfall at all: the trust fund balance is projected to be $17.1 trillion in 2080.

The trustees estimate that in 2017 the cost of current benefits will exceed payroll tax collections. Because the trust fund balance is projected to exceed $3.2 trillion (in 2005 dollars) in 2017 (almost twice the 2005 opening balance of $1.7 trillion), the Social Security system will be far from "bankrupt" in 2017. Instead, interest on U.S. Treasury bonds in the Social Security trust fund will be used to help pay benefits. (Jason Furman, Does Social Security Face a Crisis in 2018?, January 2005).

The nonpartisan Congressional Budget Office (CBO), which adopts a less pessimistic set of economic assumptions than the trustees' intermediate scenario, projects that the Social Security trust fund has enough money to pay all scheduled benefits for the next 47 years, until 2052 (Congressional Budget Office, The Outlook for Social Security, June 2004). Under the CBO's updated projections, when the trust fund runs out of money in 2052, the payroll taxes coming in will still be sufficient to pay retirees about 78% of scheduled benefits (Congressional Budget Office, Updated Long-term Projections for Social Security, January 2005).

[back to top]

Isn't the Social Security trust fund just an "accounting fiction?"

The government is required, by law, to invest surplus Social Security funds in U.S. Treasury bonds. These bonds are backed by the full faith and credit of the U.S. government. U.S. Treasury securities are considered the safest investment available. In the past, Social Security has operated in deficit—that is, benefits paid out have exceeded revenues—in 14 separate years. It was able to redeem its bonds without

problem each time. (Lee Price of EPI, Implications of the Bush budget for people over 55, March 2005; Roger Lowenstein, A Question of Numbers in The New York Times Magazine, January 16, 2005; Mark Weisbrot and Dean Baker of Center for Economic Policy Research (CEPR) , What Crisis? It Ain't Broke, So No Need to Fix It, *The Washington Post*, January 23, 2005). There is no reason to believe that the U.S. government would not make good on the value of the bonds in the Social Security trust fund, any more than it would default on the bonds held by private investors in the United States or abroad. (See Dean Baker of CEPR, Defaulting on the Social Security Trust Fund: What It Would Mean, and How It Would Be Done, March 9, 2005).

[back to top]

Is the long-term Social Security shortfall $4.0 trillion or $11.1 trillion?

The Bush Administration and some members of Congress have alleged that Social Security has a shortfall of $11.1 trillion. What is not clarified is that this estimate is over an infinite time frame. The American Academy of Actuaries has discouraged using this infinite time horizon, saying it is misleading and provides "little if any useful information." (Letter from Eric J. Klieber, Chairperson, Social Insurance Committee, American Academy of Actuaries, to Trustees of the Social Security System, December 19, 2003, cited in Jason Furman, William G. Gale, and Peter R. Orszag, Center of Budget and Policy Priorities (CBPP), Would Borrowing $2 Trillion for Individual Accounts Eliminate $10 Trillion in Social Security Liabilities?, December 2004).

Considering a 75-year time horizon, the Social Security trustees estimate that the shortfall under their "intermediate" scenario is $4.0 trillion (in present value). A more meaningful way to express the magnitude of the Social Security shortfall is as a percentage of total GDP over this same time period. Measured this way, the Social Security trustees estimate that the shortfall is 0.6% of GDP, less than one-third the size of the 2001 and 2003 tax cuts extended over the next 75 years. The Congressional Budget Office estimates the shortfall to be even smaller—0.4% of GDP. (See Is borrowing $2 trillion for transition costs really a savings because the cost of doing nothing is $10 trillion? for more on this issue).

[back to top]

Have projections regarding the health of the Social Security trust fund changed over time?

While the Social Security trustees are required by law to make 75-year projections of the system's solvency, these estimates are by no means precise. Both the trustees' and CBO's models are based on a number of important assumptions, including changes in real earnings, productivity, inflation, immigration, birth rate, mortality, and the unemployment rate. Small changes in these assumptions can have significant effects since the projections cover a 75-year time period.

It is key to remember that the shortfall is based on one plausible scenario of life in 2052. But, ask yourself, how would a prediction of life in 1952 have looked, if it were made by someone in 1905? There were no mass-produced automobiles, no broadcast radio, no television, and the airplane was two years

old. Using the best information on technology and growth from 1880 to 1900, how accurate do you think their guess would be? That doesn't mean we should ignore the best available information and be prudent, but we should also be cautious about making rash decisions and overhauling the entire Social Security system based on such guesswork.

Due to stronger-than-predicted productivity growth over the last decade, the year at which the trust funds are estimated to be depleted has generally moved further away. In 1997, the trustees projected the trust fund would be depleted in 2029; in 2000, they projected it would be depleted in 2034; and now they're predicting 2041 (see Table 1). In fact, according to the Social Security trustees, the program is more financially secure today than it has been for most of its history. (Mark Weisbrot and Dean Baker of CEPR, What Crisis? It Ain't Broke, So No Need to Fix It, *The Washington Post*, January 23, 2005).

Table 1. Financial health of the Social Security trust fund, 75-year projections

	SS Trustees (March 1997)	SS Trustees (March 2004)	SS Trustees (March 2005)	CBO (June 2004)
Trust Fund depletion date	2029	2042	2041	2052
Shortfall as percent of payroll taxes [1]	2.23%	1.89%	1.92%	1.0%
Shortfall as percent of GDP	0.8%	0.7%	0.6%	0.4%

1. If payroll taxes were raised immediately by this amount (e.g., 1.92%), the Social Security trust fund would be adequate to pay current scheduled benefits to all retirees for the next 75 years.

[back to top]

Given that the current Social Security program is expected to fully fund scheduled benefits for the next 36 to 47 years, is Social Security really in crisis?

President Bush and others have claimed that the Social Security program is currently in crisis. The administration has admitted that convincing the American public that Social Security is on an "unsustainable course" is a "pre-condition to authentic reform." (January 3, 2005 White House email; Paul Krugman, The Iceberg Cometh in *The New York Times*, January 11, 2005). This current round of misinformation has contributed to a general public misunderstanding, with polls indicating that 63% of Americans mistakenly believe there will not be enough money left to pay Social Security benefits when they retire. (John Marttila, Are Voters Paying Attention? in *The American Prospect*, January 2005; Washington Post Polling, December 20, 2004).

The shortfall in Social Security pales in comparison to the fiscal gap caused by other major policy changes in recent years. According to the Social Security trustees, the 75-year Social Security shortfall is 0.6% of Gross Domestic Product (GDP); the Congressional Budget Office (CBO) estimates it to be only 0.4% of GDP. To put this in perspective, making the 2001 and 2003 tax cuts permanent over the next 75 years will cost 2% of GDP, more than three times as much as the Social Security trustees' estimate of the shortfall and five times as large as the CBO estimate. The new Medicare prescription drug benefit is more than twice as large (i.e., 1.4% of GDP or $8.1 trillion). So, if a fraction of the Bush Administration's tax cuts were rolled back and that money were deposited into the Social Security trust fund, the entire 75-year shortfall would disappear. (Richard Kogan and Robert Greenstein, President Portrays Social Security Shortfall as Enormous, but His Tax Cuts and Drug Benefit Will Cost at Least Five Times as Much, January 2005; Alan Blinder, Social Security and the New Fiscal Policy in *The American Prospect*, January 2005).

While addressing the potential long-term shortfall is a challenge, it is certainly not a crisis that requires urgent attention or radical change. The real fiscal crises are (1) today's budget deficits driven by tax cuts and (2) the looming pressures from Medicare and Medicaid costs driven by rising health care costs. (See Max Sawicky of EPI, Big deficit, little deficit: The Bush budget and Social Security, March 2005; Max Sawicky of EPI, Collision Course: The Bush Budget and Social Security, March 2005; and Paul Krugman, Confusions about Social Security in *The Economists' Voice*, January 2005).

[back to top]

Can private accounts solve the long-term shortfall in the Social Security trust fund?

Private accounts do nothing to close the long-term shortfall. To maintain a positive balance in the Social Security trust fund for 75 years, there must be increases in revenues and/or decreases in benefits. The Bush Administration has objected to raising payroll revenue to fix the system. That decision leaves benefit cuts as the only option the administration would accept for strengthening the Social Security trust fund. While the administration's privatization proposal will be dressed up as a new solution and a new benefit, in reality it is an effort to disguise substantial benefit cuts in the hope that workers do not understand what's really going on.

To the extent that private accounts do affect the capacity of government to make good on promised Social Security benefits, they make things worse, not better. First, money that would have gone into the Social Security trust fund will be diverted into private accounts, and this siphoning of funds will increase government borrowing and raise interest rates on all government debt. Second, many people will lose money in their accounts and not be able to repay what they have borrowed to create a private account when they die or become disabled. This could become a serious drain on the trust fund depending on the performance of stocks, bonds, individual investment choices, administrative expenses, and inflation. (See Reason #2 in Greg Anrig Jr. and Bernard Wasow, Twelve Reasons Why Privatizing Social Security is a Bad Idea, December 2004).

[back to top]

Deep Social Security benefit cuts will accompany any privatization effort.

How will current Social Security benefits be cut under privatization?

The Social Security privatization proposal will likely result in enormous across-the-board benefit cuts, whether or not a worker decides to open a private account. The President's position virtually guarantees that Social Security benefits will have to go down significantly by setting the conditions that (1) revenues may rise little, if at all; and (2) future spending on benefits will remain below revenues. Private accounts will not allow people to make up the difference. Indeed, it is likely that creating an account will make people worse off than not creating an account. According to a growing number of financial experts, the charge for creating a private account will exceed the earnings from that account for most people. (Robert J. Shiller, The life-cycle personal accounts proposal for Social Security: An evaluation, March 2005).

The Commission's Plan 2 (about which Bush Administration officials have spoken and written favorably) proposes switching from the current "wage indexing" system to a new "price indexing" system. The benefit cuts associated with this switch—not the private accounts—are what extend the life of the Social Security trust fund (see What's the difference between "wage indexing" and "price indexing"? below). Workers who decide to open a private account will have their benefits cut even further (see How much will workers get charged for diverting funds into private accounts? below). The administration has claimed that any privatization plan will not cut benefits for current retirees or near-retirees (ages 55 and up). There is reason to believe that even these individuals' Social Security may not be protected given today's budgetary problems. (See Max Sawicky of EPI, Big deficit, little deficit: The Bush budget and Social Security, March 2005; Max Sawicky of EPI, Collision course: The Bush budget and Social Security, March 2005; and Lee Price of EPI, Implications of the Bush budget for people over 55, March 2005). All other beneficiaries—including those receiving benefits under the disability and survivor programs—will almost certainly see their benefits cut.

To calculate current Social Security benefits and benefits after implementation of the White House's proposed privatization plan, taking into consideration a worker's marital status, year of birth, years out of the labor force, retirement age, and average salary, visit the Center for Economic and Policy Research's Social Security Accurate Benefit Calculator.

What is the difference between "wage indexing" and "price indexing"?

Social Security privatization will include significant cuts in Social Security benefits, regardless of whether a single private account is ever opened. Specifically, Plan 2 changes the way future Social Security benefit levels are calculated—switching from the current "wage indexing" system to a new "price indexing" system.

The current formula for Social Security benefits in the first year of retirement considers a worker's annual earnings in the 35 highest paid years, using changes in annual average wages to adjust the earnings in earlier years to reflect improvements in workers' standards of living between each earlier year and

retirement. (See American Association of Retired Persons (AARP) Fact Sheet for a detailed description of the benefit formula). That is, all 35 years of earnings are recalculated as if they had been earned in the year before retirement. Benefits after the first year of retirement, however, are increased only to reflect changes in prices, not changes in average wages. Disability and survivor benefits are calculated similarly.

Instead of continuing to calculate the initial benefit level based on improvements in average wages in the economy, Plan 2 would calculate initial benefit levels based on changes in prices in the economy. Because prices do not rise as quickly as wages, a worker's benefits would be reduced about one percentage point for each year after the change goes into effect. Under this new formula, Social Security will replace a smaller and smaller portion of a worker's pre-retirement wages over time.

Price indexes are meant to reflect what it would take to maintain a fixed lifestyle. So, if in 1965 benefits had been fixed and indexed to inflation, today's retirees would be able to live as Americans did in 1965. Imagine in the long run what that would mean. In 2042, today's 20-year-olds would be forced into a standard of living more appropriate to 1965.

One way to evaluate the impact of these benefit cuts is to consider the changes in the "replacement rate" (i.e., the percentage of wages that Social Security replaces) over time. Under the current system, the replacement rate remains relatively constant from generation to generation. That means beneficiaries share in the overall standard of living increases that the whole society receives. Today, the average replacement rate for a retiring 65-year-old is about 42%. However, if initial benefits are calculated using price inflation, the replacement rate for the average worker will decline to 27% in 2040 and 18% in 2075. (Lee Price and David Ratner of EPI, Proposal by the president's Social Security Commission whittles away at income support, January 12, 2005). These cuts also erode the progressivity of Social Security benefits, because lower-wage workers who rely more on Social Security income face more drastic cuts in their replacement rates than higher-wage workers. These benefit cuts might affect not just retirees, but also the 7.2 million disabled workers and their families and the 6.9 million individuals who receive survivor benefits.

In March 2005, the President spoke favorably about retaining pure wage indexing for the lowest paid workers, moving to pure price indexing for high wage earners, and using a blend of the two for workers in between. In practice, this would cut benefits for middle income workers very substantially. Over time, Social Security would evolve from being a progressive pension program into a program with almost the same guaranteed minimum benefits for everyone. (See Jason Furman of CBPP, An analysis of using "progressive price indexing" to set Social Security benefits, March 2005, and Jason Furman, Robert Greenstein, and Gene Sperling of CBPP, Why progressive price indexing could lead to the unraveling of Social Security, April 2005).

For further discussions of the anticipated cut in benefits due to the change to price indexing, see:

- Amy Chasanov of EPI, Proposed Social Security price indexing would slash benefits, February 9, 2005 (based on Congressional Research Service, Memo to Senate Finance Committee re: estimated effect of

price-indexing Social Security benefits on the number of Americans 65 and older in poverty, January 28, 2005).

- Lee Price and David Ratner of EPI, Proposal by the president's Social Security Commission whittles away at income support, January 12, 2005
- Robert Greenstein of Center on Budget and Policy Priorities (CBPP), So-called "price indexing" proposal would result in deep reductions over time in Social Security benefits, December 2004
- Alison Shelton, Laurel Beedon, and Mitja Ng-Baumhackl of AARP, The effect of using price indexation instead of wage indexation in calculating the initial Social Security benefit, July 2002
- Peter Diamond and Peter Orszag, CBPP and The Century Foundation, Reducing benefits and subsidizing individual accounts, June 2002

[back to top]

How much will workers get charged for diverting funds into private accounts?

Workers who decide to open private accounts will have their traditional Social Security benefits cut back even further. The amount of a worker's contribution into the private account will be subtracted from his or her traditional Social Security benefits, compounded at 3% interest plus inflation over time. In other words, people would borrow from the federal government at a real interest rate of 3% plus inflation and invest that money in the stock market; they would have to repay the borrowed money when they retire. This is sometimes referred to as the "clawback." Recent surveys by the *Wall Street Journal* and Bloomberg News have found a consensus among Wall Street analysts that stocks will have a return of 4-1/2 to 5% return above inflation in the future. If people hold a mix of stocks and bonds as widely recommended, their total return would average in the 3 to 3-1/2% range. Administrative costs are likely to be higher than the White House has claimed because (1) private accounts would require far more precise and timely record-keeping than today's Social Security records and (2) the U.S. labor market has rapid turnover in both employers and employees. Therefore, over long periods of time, private accounts would likely average a net return of less than 3% above inflation during some periods and above 3% at others. (See Robert Shiller, The life-cycle personal accounts proposal for Social Security: An evaluation, March 2005; Alison Fitzgerald and Michael Forsythe, Stock-market returns may not meet Bush's Social Security hopes, Bloomberg News, March 28, 2005; Christopher Lee, Bush proposal differs greatly from model, *The Washington Post*, March 2, 2005; Whitehouse, Mark, Social Security Overhaul Plan Leans on a Bullish Market, *Wall Street Journal*, February 28, 2005; and Tom Petruno, When 3% may be a bum number, *Los Angeles Times*, February 27, 2005).

[back to top]

The government will have to borrow trillions to fund private accounts.

In addition to benefit cuts, what other costs are associated with privatization?

There are a number of other costs associated with privatization. First, there are trillions of dollars in "transition" costs that are necessary to continue making payments to current beneficiaries once workers are able to open private accounts. (See What are the transition costs associated with privatization? below). Second, the administrative costs associated with managing the new private accounts will be very high. (See What are the administrative costs associated with privatization? below). Third, there will be significant new risk for workers investing in private accounts. (See Will the cuts in guaranteed Social Security benefits that accompany privatization be offset by higher returns on private accounts? below).

[back to top]

What transition costs are associated with privatization?

To minimize transition costs in the near-term, the White House has said it would phase in private accounts between 2009 and 2011, providing the option to older workers first. (For example, only workers age 40 to 54 would be able to open an account in the first year.) Nonetheless, the transition costs will accumulate to $4.9 trillion in the first 20 years of operation. (Jason Furman and Bob Greenstein of CBPP, An overview of issues raised by the administration's social security plan, February 7, 2005).

Because the federal government is currently running very large deficits, the private accounts cannot be created from surplus general revenues but would require new borrowing. These transition costs undermine the benefits of the reform because they offset any increase in national savings with increased national debt. (Alan Blinder, Social Security and the New Fiscal Policy in *The American Prospect*, January 2005).

[back to top]

Is borrowing $4.9 trillion for transition costs really a savings?

The Bush Administration claims that this new borrowing is a good deal because it will result in long-term savings, whereas the cost of doing nothing is $11 trillion. These claims are untrue. The $4.9 trillion in "costs" refers to the transition costs in the first two decades that private accounts are adopted—the transition costs will be much more over the first 40 to 50 years. (Jason Furman and Bob Greenstein of CBPP, An overview of issues raised by the administration's social security plan, February 7, 2005 and Paul Krugman, The Iceberg Cometh in Th*e New York Times*, January 11, 2005). The $11 trillion in "savings" refers to the Social Security shortfall over an infinite time frame. The American Academy of Actuaries has discouraged using this infinite time horizon, saying it is misleading and provides "little if any useful information." (Letter from Eric J. Klieber, Chairperson, Social Insurance Committee, American Academy of Actuaries, to Trustees of the Social Security System, December 19, 2003, cited in Jason Furman, William G. Gale, and Peter R. Orszag, CBPP, Would Borrowing $2 Trillion for Individual Accounts Eliminate $10 Trillion in Social Security Liabilities?, December 2004). This new borrowing does not close the $11 trillion gap over an infinite time horizon, or the $4.0 trillion gap over the next 75 years. In fact, the new

borrowing makes the trust fund outlook worse, not better. Instead, it is the serious cuts in guaranteed Social Security benefits the Bush Administration proposes for all beneficiaries that make up for any Social Security shortfall.

[back to top]

Will the additional costs of privatization negatively affect the overall economy?

The transition costs associated with privatization will undoubtedly drive up the federal debt and the federal budget deficit. It will take a long time—perhaps 40 to 75 years—for the trust fund's savings from benefit cuts to generate enough revenue to offset the loss of payroll taxes diverted into private accounts. Until then, there will be significant transition costs. Every other country that has privatized its Social Security program has offset the immediate loss of revenue with spending cuts and/or tax hikes. (Dean Baker of CEPR, Bush's Numbers Racket in *The American Prospect*, January 2005).

It is very difficult to predict how encouraging people to buy stock financed by increased federal debt will affect the economy, and economists disagree on the matter. Some economists believe the increased debt burden will decrease national savings and increase interest rates, making the cost of homes, cars, student loans, and credit higher than without privatization. Higher interest rates will also decrease capital investment by companies. As a result, the increased debt will create a vicious cycle—depressing productivity and economic growth, ultimately leading to a larger deficit and leaving less money to fund the Social Security program. (Reason #3 in Greg Anrig Jr. and Bernard Wasow, Twelve Reasons Why Privatizing Social Security is a Bad Idea, December 2004; William Dudley, Jan Hatzius, and Edward McKelvey, Thoughts on Social Security Reform, Goldman Sachs Global Economics Paper No. 120, January 18, 2005). Economists Peter Diamond and Peter Orszag have also argued that privatization will not increase national savings, but actually decrease it. That's because households may consider these new private accounts to be new retirement savings wealth and may, as a result, reduce their other saving.

The Congressional Budget Office, however, projects that real gross national product (GNP) will be slightly higher than under current law and that budget surpluses would grow (given increasing growth in tax base and leveling of benefits paid out). CBO also predicts the benefit cuts will change consumer behavior by reducing spending and increasing retirement savings. (CBO, Long-Term Analysis of the President's Commission to Strengthen Social Security's Plan 2, 2004).

[back to top]

The administrative costs to fund private accounts may be huge.

What administrative costs are associated with Social Security privatization?

There are five types of new administrative costs associated with privatization: costs related to new government infrastructure, fees to manage the accounts, fees to convert private account balances into lifetime annuities, supplemental insurance costs, and costs associated with new employer activities. These

costs will be paid directly by the government, employers, or workers—but in the end the American public will pay the price of privatization in the form of higher taxes, lower wages, fewer government services, or higher fees that erode the balances of the private accounts.

New government infrastructure. Privatization will require the U.S. government to undertake a number of expansive, new activities and will result in new government bureaucracies. The government will directly or indirectly have to track each worker's payroll taxes and ensure they are deposited in the proper accounts, in a timely manner, and invested in the options a worker chooses. This record-keeping would have to be far more precise, complex and timely than under the current Social Security system. Moreover, the U.S. labor market has very high turnover of employers and employees. One expert (the person charged with developing the administration of the federal Thrift Savings Plan) has called the White House cost estimates "ridiculously optimistic," given the high turnover of employers and employees and current reporting lag. (See Christopher Lee, Bush proposal differs greatly from model, *The Washington Post*, March 2, 2005).

Management fees are a critical aspect of Social Security privatization. Most legislation to privatize Social Security that has been introduced in Congress would allow individuals to choose among a large number of private investment firms to manage their individual accounts. Well aware that high management fees have eroded gains for privatized accounts in foreign countries, the White House has said it would follow the Thrift Savings Plan (TSP) model. TSP allows only five investment options that closely track major investment indexes. Private investment firms bid for the right to manage each of the five funds. All record-keeping on individual accounts would stay within the government. The financial services industry has been in favor of private accounts because Wall Street could make huge brokerage fees on the billions of dollars that would be invested in private accounts. A University of Chicago economics professor has estimated that the net present value of payments of financial fees to private companies would be $940 billion over 75 years, the largest windfall gain in American financial history. (Austan Goolsbee, The Fees of Private Accounts and the Impact of Social Security Privatization on Financial Managers, September 2004). The Securities Industries Association, in whose interest it is to minimize the fees it says it will collect, has estimated that the financial industry would make just $39 billion over 75 years. (Heidi Przybyla, Companies to Spend Over $5 Million To Back Bush on Social Security in Bloomberg News, January 20, 2005).

Management fees add up over the life of an individual's account. The CBO estimates that the administrative costs under the current Social Security system reduce a worker's account asset balance by only 2% at retirement. By contrast, the CBO estimates that the average annual administrative cost of a mutual fund that received 2% of taxable earnings would be 1.09%, and would result in a 23% reduction in a worker's account assets at retirement. (CBO, Administrative Costs of Private Accounts in Social Security, March 2004).

Fees to convert private account to lifetime annuity. Plan 2 assumes retirees will convert their private accounts into annuities that provide them with monthly payments until their death. This is yet another cost that will reduce a worker's private account balance. Relatively few people buy these annuities now, so it is unclear how expensive they will be. Some have estimated that, even after paying management fees for the life of the private account, individuals will face an additional cost equal to 15% to 20% of their entire account to

create a lifetime annuity. (Dean Baker and David Rosnick of CEPR, Basic Facts on Social Security and Proposed Benefit Cuts/Privatization, November 2004; CBO, Administrative Costs of Private Accounts in Social Security, March 2004). A study panel convened by the National Academy of Social Insurance (NASI) released a report in January 2005 that details all the unanswered questions associated with handing out benefits through private accounts. The report addresses many issues, including how annuities could be structured and whether the government or the private sector should provide them. (Study Panel Final Report, NASI, Uncharted Waters: Paying Benefits from Individual Accounts in Federal Retirement Policy, 2005).

Potential fees to provide supplemental insurance benefits. Only half of new Social Security beneficiaries are retired workers. The other half are family members of retired workers, disabled workers and their families, and workers' survivors. Private accounts are scheduled to cover only the benefits to the retired workers. Under Plan 2, Social Security will continue to provide a widow and spousal benefit, but those benefits are likely to be at a lower level than before. How will the workers' entire family continue to be protected in the case of early death or disability? A possible scenario would be to make workers purchase an insurance product to cover the dramatic loss in disability and survivors' benefits. This additional cost would drastically reduce the return workers receive on their accounts.

Employer costs. Privatization may also require employers to take on a number of new activities that will be costly, particularly to smaller employers. The extent of these new responsibilities will vary depending on whether there is centralized, governmental administration of the program (for example, using existing structures at the Social Security Administration and the Internal Revenue Service), or decentralized, employer-based administration and record keeping. The White House has said the program would be more centralized. (See White House, Strengthening Social Security for the 21st Century, February 2005). However, to the extent that administration is decentralized, new employer activities might include depositing contributions with financial institutions, educating employees about the private accounts, taking on new fiduciary responsibilities, and monitoring and correcting errors. In addition, the Congressional Research Service notes that, as a result of these new costs, employers may shrink their pension sponsorship or cut back on their matches in current 401(k) plans, which might decrease employee participation in those plans. (Memo from Patrick Purcell, Congressional Research Service re: Social Security Individual Accounts and Private Pensions, March 2004).

[back to top]

Americans will be worse off under privatization.

Won't most retirees be better off under privatization?

Under any privatization plan, all workers would face more risk and deeper benefit cuts than under today's Social Security program (Josh Bivens of EPI, Privatization fix for Social Security is worse than doing nothing, January 26, 2005). If individuals do not invest in a private account, they would certainly be worse off because they would face benefit cuts without the ability to make up the difference through additional returns. But even if individuals do invest in private accounts, most accounts are unlikely to make up the difference, since the accounts will have significant administrative costs attached, will be riskier

investments, will be limited in the yearly amount that can be contributed, and may be expensive to convert into an annuity. Married couples would certainly be worse off, since the structure of the program would be changed to focus on individual workers, thus losing the family benefit formula in current law. Some individuals—such as higher wage earners—may be better off if they invest in riskier assets and that risk pays off. However, such investments are better left to individual voluntary contributions in 401(k)s and IRAs, not to Social Security, which is meant to be the bedrock of a worker's retirement income.

[back to top]

What will be the likely effect of the President's plan to price index benefits and create private accounts?

The nonpartisan Congressional Research Service (CRS) recently modeled the President's proposal for Social Security reform based on February 2005 statements by the White House. (Congressional Research Service, Estimated Social Security benefit levels under President Bush's 2005 individual accounts proposal combined with a proposal to price-index Social Security benefits, March 31, 2005). CRS assumed that private accounts were created and that future Social Security benefits would be indexed with prices, not wages. Their analysis illustrates three main points. First, a change from wage to price indexing gradually reduces the guaranteed Social Security benefit over time. For example, an average earner who is 41 in 2005 would receive a guaranteed Social Security monthly benefit is $968, whereas the benefit of an average earner born today would be only $214. Second, over time, workers would receive more of their benefits from their private account. A 41-year-old with average earnings would earn $220 from their private account, whereas the private account benefit of an average earner born today would be $916. Third, workers' combined benefits under privatization (i.e., guaranteed benefit plus private account benefit) would be lower than what their guaranteed benefit would have been under Social Security. At retirement, a 41-year-old worker with average earnings would have a combined monthly benefit of $1,188, or 84.6% of the $1,404 scheduled Social Security benefit, whereas a worker born today would have a combined benefit of $1,130, only 52% of the $2,173 scheduled Social Security benefit.

[back to top]

Privatization proponents have misled many groups into thinking they're better off under privatization.

How are survivors and disabled workers and their families treated under privatization?

About one-third of all Social Security recipients receive disability insurance or survivor insurance benefits: 5.5 million disabled workers, 1.7 million spouses and children of disabled workers, and 6.9 million spouses and dependent children of deceased workers. If you consider just new beneficiaries in November 2004, only half were retirees and the rest survivors and disabled. For an average young earner with a spouse and two young children, Social Security is the equivalent of a $403,000 life insurance policy and a $353,000 disability insurance policy in 2001. (SSA Memo to Stephen Goss, *Present Values of Expected Survivor and Disability Benefits for an Illustrative Case*, July 23, 2001). The disability and survivors programs provide benefits to multiple beneficiaries (worker, spouse, and/or child) across

multiple generations based on one wage earner's contributions (United Cerebral Palsy, Social Security Reform Fact Sheet, 2004). In fact, more low-income children live in families who benefit from Social Security than from the Temporary Assistance to Needy Families (TANF) program. (See Heather Boushey of CEPR, Social Security: The most important anti-poverty program for children, March 28, 2005). Much of the discussion surrounding Social Security reform, however, ignores these crucial programs and the beneficiaries they help. (See William E. Spriggs of EPI, Bush plays down SSA benefits to widows, disabled, March 2005 and William E. Spriggs, Walkmans to iPods: Social Security is better equipped to provide family income protection, February 2005).

The reforms set forth in the Commission's report focused exclusively on the retirement program, not the disability insurance program or the survivor program. The Commission punted on how to treat individuals receiving disability benefits, encouraging the president to address disability insurance in a separate forum on the grounds that the issues were complex and demanded further study (President's Commission, Strengthening Social Security and Creating Personal Wealth for all Americans, December 2001). People with disabilities and their families benefit from the fact that all three programs rely on the same benefit formula to provide a guaranteed monthly payment that is increased each year for inflation. Because many people move among Social Security's three programs, treating each program's beneficiaries differently would complicate benefits. To make their numbers work, the Commission assumed that comparable cuts in benefits that apply to retirees would apply to disabled workers as well. Yet, the Commission explicitly stated that it did not recommend this policy be implemented.

It is not clear whether the administration would preserve the existing disability and survivor benefits. Preserving such accounts would greatly increase the cost of private accounts since they are 30% of all current beneficiaries (and prevent Plan 2 from achieving actuarial balance). These essential protections would face substantial future cuts that can never be made up for by the private accounts. That's because preparing for a planned retirement is much different from an unplanned disability or early death, which inevitably renders a worker or her family financially unprepared for the abrupt loss of income. No one wants to think that they will become disabled or die before retirement, and few are in a financial position to save for these eventualities or have adequate private insurance. Nonetheless, a 20-year-old has a 3-in-10 chance of becoming disabled at some point and a 1-in-6 chance of dying before retirement (Lori Hansen (NASI), Social Insurance...Explained). Workers and families on the wrong side of these odds have a shorter work life and much lower ability to put away enough savings in their private accounts for themselves and their families.

The Commission's Plan 2 does adopt some benefit increases for low wage earners that apply to the disability and survivor portion of Social Security. Plan 2 calls for a "low-earner enhanced benefit" for some Disability Insurance (DI) beneficiaries and an increase in the benefits received by low-income widows and widowers. These enhancements would offset some of these benefit cuts. However, only a limited number of beneficiaries will benefit, and these increases are unlikely to make up for the other benefit cuts they will face.

Even if the current, higher benefit levels are maintained for disability and survivor benefits under a reform package, there will be complications and inequities across the three programs. For example, once disabled

workers reach retirement age, they would presumably continue to switch from the disability to retirement program and, as a result, face significant benefit cuts. To date, there has been no serious attempt to ensure that the needs of these 14 million beneficiaries are met. As a result, widow(er)s, children, and disabled workers and their families will be worse off under privatization than under the current system.

Disability Insurance does maintain a separate trust fund. It is incorporated in the Social Security Trustees report as combined in the OASDI trust. But, the presence of this fund has led some, like the Heritage Foundation, to suggest that the disability program could be cut out of the Social Security system, and disability payments could remain as under current law. The DI trust fund, however, is in even more trouble than the OAS trust fund, because of (1) the increase in the potential number of workers covered (the age for eligibility has been declining), (2) the number of workers who otherwise might have died (pushing them into the OAS trust fund) but now survive accidents or severe health issues, and (3) the longer life of those with disabling conditions. Divorcing DI from the rest of the program would simply add another trust fund problem to be solved.

For more on the disability insurance program, see:

- Consortium for Citizens with Disabilities, Fact Sheets
- Marty Ford of Consortium for Citizens with Disabilities, Statement on Social Security Reform, December 16, 2004
- United Cerebral Palsy, Social Security Reform Fact Sheet, 2004
- Marty Ford of Consortium for Citizens with Disabilities, Testimony at Hearing of President's Commission Final Report, October 3, 2002
- Judy Chesser of United Cerebral Palsy, Testimony before President's Commission to Strengthen Social Security, October 17, 2001

[back to top]

Are high and low income workers helped equally by private accounts?

Low-income workers—who are disproportionately women and minorities—are more likely to be hurt by privatization than high-income workers. The current Social Security benefit calculations help low-income workers in three distinct ways: benefits are indexed with wages; low earnings years are ignored; and benefits are progressive. Low-wage workers are likely to be hurt by privatization because they have fewer income sources and these workers are more likely to become disabled or die young.

First, benefits are currently indexed based on the wage growth experienced by all workers. Even though the minimum wage has been stuck at $5.15 for eight years and low-wage workers earning above the minimum have not seen appreciable increases in their wages in recent years, they benefit from the fact

that middle- and upper-income workers' wages have been rising at greater rates. Therefore, low-wage workers get to share in the general wage gains of the entire economy, despite the fact that their wages have been relatively flat. Privatization will switch from wage indexing to price indexing, eliminating this current advantage to low-wage workers.

Second, many low-wage workers, and women and minorities in particular, have low earnings early in their work lives. Because Social Security uses only the top 35 years of earning, it ignores times of low employment and earnings, which typically occur in those early years. With private accounts, earnings in one's early years become more important because the savings from the early years are compounded over a longer time period. Women who take time out for child care early in their careers are greatly disadvantaged by this. The very high rates of unemployment among young African Americans similarly hurt their savings.

Third, Social Security currently provides progressive benefits, replacing a higher percentage of low-wage workers' earnings than middle- and high-income earners. For workers born in the 1940s who retire today, Social Security replaces more than 70% of the earnings for workers from the lowest earnings quintile (i.e., bottom one-fifth of earners), replaces 42% of the earnings of median-wage workers, and less than 30% of the previous earnings of workers in the highest quintile (Congressional Budget Office, The Outlook for Social Security, June 2004). Under Plan 2, replacement rates for low-earning workers would be enhanced somewhat—raising the minimum benefit payable to an individual who worked for at least 30 years at the minimum wage to 120% of the poverty line. However, estimates by CBO suggest that many workers in low-earning households would still be worse off under privatization than under scheduled benefits. As **Figure 1** shows, Social Security would provide low-earning workers born in the 1980s a replacement rate (in the first year) of 70% under current law, 66% if no changes are made to address the so-called "crisis," but only 55% under the privatization plan. The picture is even worse for a low-earning worker born in the 2000s—their replacement rate would go down to 44% if Plan 2 is adopted (see Figure 2 below and Josh Bivens of EPI, Privatization fix for Social Security is worse than doing nothing, January 26, 2005; CBO, Long-term analysis of the President's Commission to Strengthen Social Security's plan 2, 2004).

FIGURE 1: Replacement rates for retirees age 65 between 2045 and 2055 (median worker in each earnings quintile)

Low-wage workers also have less non-Social Security income to depend on in their retirement. On average, Social Security provides 39% of earnings for the population 65 and older. For older individuals in the lowest quintile of earnings, Social Security benefits provide 82% of their income. For those in the middle quintile of earnings, Social Security benefits provide 64% of their income. In contrast, for older individuals in the highest quintile of earnings, Social Security is only 19% of their retirement income. (Social Security Administration, Income of the Aged Chartbook-2001, 2003; Social Security Administration, Income of the Population 55 or Older-2000, 2002).

Poorer workers are also more likely to be disabled or to die young, leaving them less time to build assets in their private accounts and unable to close the gap imposed by new widespread benefit cuts. One key aspect of account "ownership"—the ability to pass on an account as an inheritable asset to one's survivors—is of limited use to low-wage workers, since these accounts are likely to be modest.

[back to top]

Won't privatization help African Americans because their shorter lives mean they draw Social Security for fewer years?

Privatization proponents often argue that the current system is inherently unfair to African Americans

because they have shorter life expectancies and therefore they will be better off under privatization. This longevity argument ignores the many ways that African Americans benefit from the current Social Security system: African Americans have a higher disability rate, disproportionately receive survivor benefits, and have lower than average wages (Greg Anrig Jr. and Bernard Wasow, Twelve Reasons Why Privatizing Social Security is a Bad Idea, December 2004). This argument also ignores the key reasons why African Americans do not live as long as whites: persistent, fundamental inequalities in access to quality health care, education, and employment. Social Security privatization does nothing to ameliorate these important problems, but instead assumes they will persist for the foreseeable future (Paul Krugman, Little Black Lies in *The New York Times*, January 28, 2005).

Racial differences in life expectancy. While it is true that African Americans have shorter life expectancies, the life expectancy of African American women and white men is roughly the same—it is African American men who are more likely to die in their middle years. This low life expectancy is due to higher death rates in childhood and young adulthood. Since African American men who make it to 65 live almost as long as white men, to determine whether Social Security is fair to African Americans, one must consider not just their likelihood of receiving retirement benefits, but also the likelihood that the worker or his family receives survivor and/or disability benefits. Social Security is a family benefit, and African American families are much more likely to benefit from the disability and survivor insurance than their white counterparts. While African Americans are roughly 12% of the U.S. population, they are 17% of disabled worker beneficiaries and 23% of children beneficiaries. Just over half of African Americans (54%) who get Social Security benefits are retired workers; the remaining 46% receiving Social Security get disability benefits, survivor benefits, or benefits as the dependent of a retiree. (Social Security Administration, Annual Statistical Supplement: 2003, July 2004). And, on average, the disability benefits a worker receives and the survivor benefits a family receives are more likely to exceed the contributions the worker put in.

One simple statistic demonstrates the program's overall fairness to African Americans: African American workers pay about 9% of the payroll taxes that finance Social Security, and each year they receive about 9% of the benefits paid out by Social Security. This equity is only possible because those who receive disability and survivors benefits receive equal treatment, and because the program is written to insure families, not individual workers. These disability and survivor benefits are crucial for keeping African American children and families out of poverty. The President's Commission made clear that disability and survivor's benefits would be reduced under privatization, along with retirement benefits. This would significantly harm African Americans since they will have their benefits cut and be left with less ability to make up the difference if forced to rely upon private accounts.

Racial differences in earnings and employment histories. African American workers still earn lower wages than white workers, and they are more likely to live in poverty. African Americans are also more likely to have longer spells of unemployment and underemployment, which decrease their lifetime earnings. As discussed above, the current structure of Social Security benefits—specifically, its wage indexation and higher replacement rates at lower incomes—favors lower-income and middle-income workers and helps lift families out of poverty. Private accounts would erode the progressive nature of Social Security benefits and make African Americans' retirement income less secure.

Fewer sources of retirement income. African Americans are more likely than whites to rely on Social Security as their sole source of income in old age. Social Security benefits are the only source of retirement income for 40% of older African Americans. Without Social Security, their poverty rate would almost triple, jumping from 22% to 64% (National Committee to Preserve Social Security and Medicare, Why Social Security is Important to African Americans, October 2004). Continued workplace discrimination keeps African Americans from receiving pensions and building up other types of assets. Privatization will not address that discrimination, but it would decrease their retirement income. Current gaps in earnings between African Americans and whites will translate into even higher gaps in retirement income under Social Security privatization, since African Americans are likely to have lower private account savings, less private pension coverage, and higher risk of poverty. Private accounts will jeopardize this important source of income African Americans have in retirement.

For more information on how African Americans will be harmed by privatization, see:

- Dean Baker of CEPR, Empty promise: The benefit to African American men of private accounts under President Bush's Social Security plan, February 2005
- Paul Krugman, Little Black Lies in *The New York Times*, January 28, 2005
- William Spriggs, Another Mistaken Racial Stereotype in *The American Prospect*, January 2005
- Maya Rockeymoore of Congressional Black Caucus Foundation, The Social Security Privatization Crisis: Assessing the Impact on African American Families, January 2005
- Greg Anrig Jr. and Bernard Wasow of The Century Foundation, Twelve Reasons Why Privatizing Social Security is a Bad Idea (Reason #11), December 2004
- William Spriggs, African Americans and Social Security: Why the Privatization Advocates are Wrong, November/December 2004
- Laurel Beedon and Ke Bin Wu of AARP, Social Security and African Americans: Some Facts, June 2003
- Valerie Rawlston and William Spriggs, Social Security Helps Reduce Child Poverty, 2000

Hispanics will also be hurt by privatization for the following reasons: (1) on average, they have lower incomes and benefit from the progressive benefit formula; (2) at age 65, they live 3 to 4 years longer than non-Hispanics and therefore benefit from the lifetime guarantee; (3) they have a higher disability rate; and (4) they are less likely to have additional sources of retirement income. (See Social Security Administration, Hispanic Americans and Social Security, July 2004).

[back to top]

Are women and men helped equally by private accounts?

Social Security is gender-neutral and does not explicitly treat men and women differently. If women and men had identical earnings histories, life spans, and life situations, they would receive identical Social Security benefits. Because, on average, men and women differ in each of these areas, Social Security's inflation-adjusted, lifelong benefit guarantee is more essential to women, and they have much to lose if privatization is adopted.

Gender differences in life expectancy and life situation. Women live longer than men—at age 65, women are likely to live three years longer than men—and are therefore likely to collect benefits longer than men. Women over age 65 are also three times as likely as men to be unmarried and to live alone. Women are therefore more likely than men to rely on spousal and survivor benefits.

If private accounts are adopted and annuities are not required, many women would face a higher likelihood of outliving their retirement savings. But, women would also have problems if they converted their private account into an annuity. Private insurance providers do consider gender when calculating annuities. So, even if the balance of a woman's private account were equal to that of a man's (which, on average, it will not be), she would receive a lower initial monthly benefit (since the company would assume she would live longer) that would not keep up with inflation.

A woman's property rights to her husband's Social Security benefit are set by federal law. How those rights would be protected under a system of private accounts has not yet been settled by privatization proponents. Spousal rights to other retirement savings vehicles (i.e., 401(k)s and IRAs) are currently set by state law on marital property rights. Unless new federal law is enacted, a woman's right to her spouse's private account may vary by state depending on each state's laws on marriage property rights.

Differences in earnings and employment histories. Despite women's rising labor force participation and the partial closing of the gender pay gap (on an annual basis), women still earn a lower average wage than men and have lower lifetime earnings. Women work fewer years than men because they take more time out of the labor force for care giving. Under the current system, because women are more likely to be lower-wage workers, women are likely to receive a higher replacement rate. At retirement, a married worker is eligible for "spousal" benefits, receiving the larger of two Social Security benefits: whatever that worker earned from her own work history, or 50% of her spouse's benefit. Many women have historically been absent from the labor force, worked fewer years than their husbands, or had lower earnings than their husbands. As a result, 62% of women receiving Social Security retirement benefits rely on their husband's earnings records to set their benefit levels. Even with that allowance, women's annual Social Security benefits are roughly 70% of men's benefits. Privatization is therefore likely to exacerbate the difference between women's and men's income at retirement.

Fewer sources of income. The Social Security benefits that women receive are more important to them than they are to men. Women are much less likely to have other sources of income such as assets, an employer-provided pension, or other earnings. To the extent that women do have other sources of retirement income, they are likely to be smaller than men's. (National Committee to Preserve Social Security and

Medicare, Questions and Answers on Women and Social Security Privatization, 2004). As of 2000, single women over 65 received 51% of their retirement income from Social Security, while older single men received 37% of their retirement income from Social Security (Social Security Administration, Income of the Population 55 or Older-2000, 2002). The median nonmarried woman 65 or older received 84% of her income from Social Security. (Michael Ettlinger and Jeff Chapman of EPI, Social Security Income and the Elderly, March 23, 2005.) Of all women over 65, 12.4% live in poverty. The poverty rates for older African American women (26.0%) and for Hispanic women (24.4%) are more than double the poverty rate for white women (10.3%). Social Security keeps another 39% of all women 65 and older out of poverty (Sara Rix and Laurel Beedon of AARP, Social Security and Women: Some Facts, October 2003).

Because women are more likely than men to receive benefits as a survivor or spouse of a retired worker, women are 57% of all Social Security beneficiaries (Social Security Administration, Annual Statistical Supplement: 2003, July 2004). And because women collect benefits longer and are helped more by the benefit formulas, women pay only 39% of all payroll taxes but collect 48% of the benefits (Social Security Administration, Annual Statistical Supplement: 2003, July 2004 and Social Security Administration, Earnings and Employment Data, 2002, December 2004).

There are two aspects of Plan 2 that are more likely to help women than men, given women's longevity and lower lifetime earnings. First, Plan 2 would increase the amount of benefits lower-earning widow(er) s receive: currently they receive 50% to 67% of the couple's total benefits and that would be increased to 75%. Second, a couple that divorces prior to 10 years of marriage receives no credit for their spouse's Social Security benefit today. Plan 2 allows a spouse to have half of the private account assets accumulated during marriage (i.e., contributions during marriage and all earnings on account balances earned during marriage). Both of these gender-neutral changes, however, are independent of privatization and could be adopted under Social Security today if policymakers chose to improve the system's payouts to women. Nevertheless, neither change is sufficient to make up for the other losses privatization imposes on women.

For more information on how women will be uniquely harmed by privatization, see:

- Greg Anrig Jr. and Bernard Wasow, Twelve Reasons Why Privatizing Social Security is a Bad Idea (Reason #10), December 2004
- Sara Rix and Laurel Beedon of AARP, Social Security and Women: Some Facts, October 2003
- Heidi Hartmann and Sunhwa Lee of the Institute for Women's Policy Research (IWPR), Social Security: The Largest Source of Income for Both Women and Men in Retirement, April 2003
- Sunhwa Lee and Lois Shaw of IWPR, Gender and Economic in Retirement, 2003
- Bernard Waslow, Setting the Record Straight, The Most to Lose: Women and Social Security, April 2002
- Catherine Hill of IWPR, Why Privatizing Social Security Would Hurt Women, March 2000

[back to top]

Are younger workers better off with private accounts?

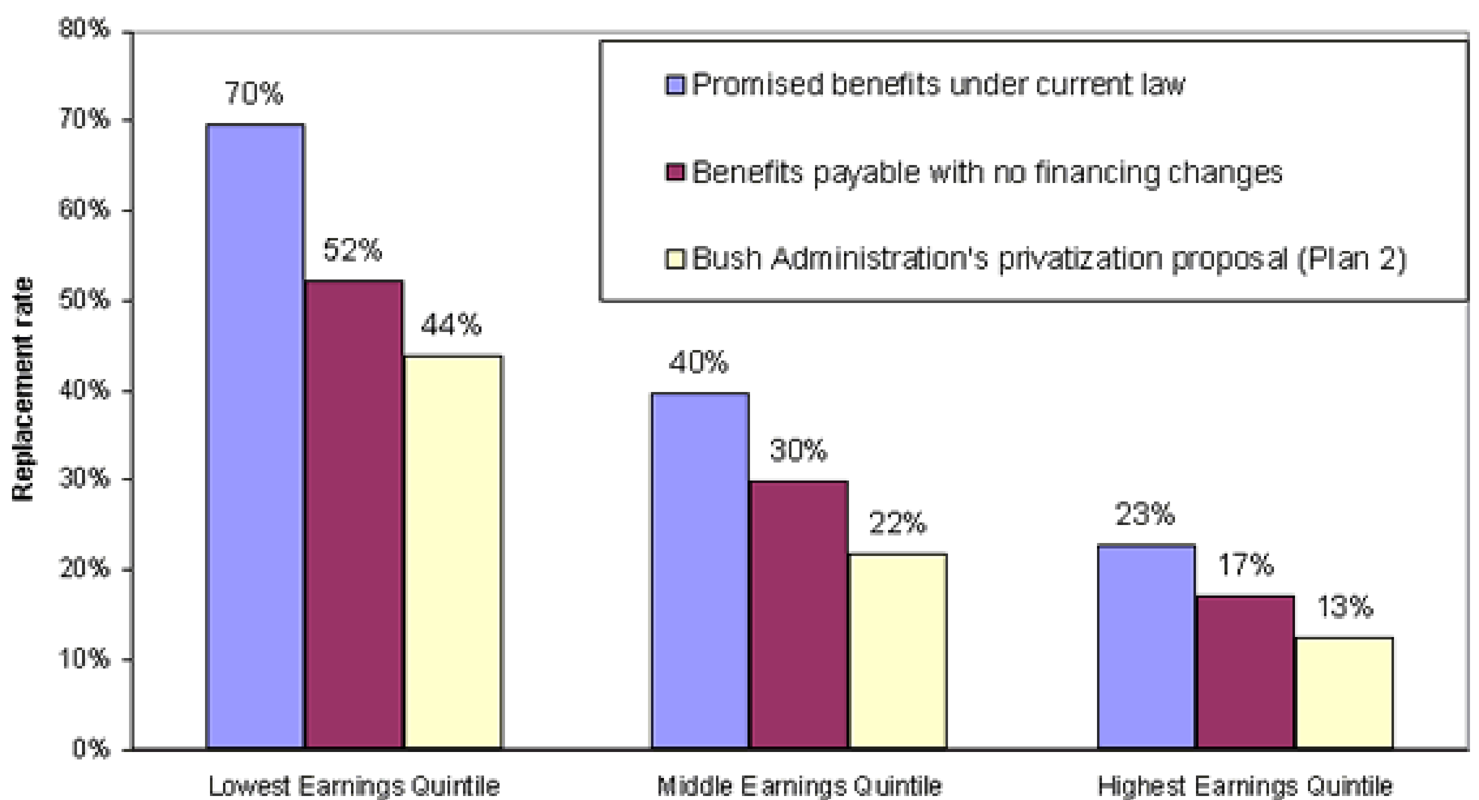
The majority of younger workers believe that the Social Security system will not be around by the time they retire. This simply isn't true. The Social Security trust fund is as strong as it has been for some time. Still, the Bush Administration has set up a false dichotomy, claiming young workers will want to choose generous private accounts over a bankrupt Social Security program. Neither of these two scenarios reflects reality.

The Social Security system is not going broke. Even if absolutely no change is made to the current system, the benefits that a worker born in the 1980s would receive at retirement would still be higher in real terms under the current system than under the privatization in Plan 2.

First, under Plan 2, younger workers will bear more of the brunt of transition costs, since significant federal borrowing is needed to continue paying existing benefits to retirees while the new private accounts are created. Younger generations will be the ones who pay back this new national debt, either in future tax hikes or reductions in government services (e.g., roads, education, etc). The new debt could also result in an economic downturn—which will undoubtedly cost some workers their jobs, depress wages, and likely hurt the market where their retirement savings are invested.

Second, under Plan 2, younger workers will face deeper benefit cuts and larger stock market risks if privatization is adopted. "To raise the rate of return for future generations by moving to a funded system, some generations must receive rates of return even lower than they would have gotten under the pay-as-you-go system" (CBO, How Pension Financing Affects Returns to Different Generations, September 2004). "In other words, one generation must pay for the cost of retirement for two: those ahead of them and their own" (Richard Leone and Libby Perl, We're all in this Together in *The American Prospect*, January 2005).

The cost to younger generations is evidenced by the decreasing replacement rates under Plan 2 over time. EPI finds that, after 35 years, the replacement rate for the average earner would decrease from its current level of 42% to 27%, and after 70 years the replacement rate would be only 18% (Lee Price and David Ratner of EPI, Proposal by the president's Social Security commission whittles away at income support, January 12, 2005). The Congressional Budget Office (CBO) makes similar findings. CBO estimates of Plan 2 indicate that low, middle and high income workers would all be worse off if privatization were adopted (CBO, Long-Term Analysis of the President's Commission to Strengthen Social Security's Plan 2, 2004). CBO estimates that a median worker born in the 1980s would have a replacement rate (in the first year) of 40% based on benefits promised under current law, 39% if no changes were made to address the so-called "crisis," but only 27% under Plan 2 (see Figure 1). Despite the common rhetoric, in general, retirement earnings under privatization will get worse over time, not better. As shown in **Figure 2**, CBO estimates that the same median worker born in the 2000s would have a replacement rate of only 22% under Plan 2 (Josh Bivens of EPI, Privatization fix for Social Security is worse than doing nothing, January 26, 2005; CBO, Long-Term Analysis of the President's Commission to Strengthen Social Security's Plan 2, 2004).



These cuts come at a time when Social Security should be more important than ever to young people. Young workers change jobs more often than their parents, making it more difficult for them to save for retirement. Employers today are also less likely to offer pension benefits to workers, and when they do, they are unlikely to provide a lifelong annuity (i.e., a defined benefit plan). Finally, stagnant wage growth over the last few years and high levels of consumer debt make it harder for today's younger workers to save for their future.

[back to top]

Privatization efforts abroad raise a red flag.

What can we learn from the experience of other countries after they privatized their Social Security programs?

A number of other countries have wholly or partially privatized their public Social Security systems with private accounts. The experience of many countries has included high administrative costs, minimal evidence of increased national saving, and, in some cases, significant increases in government deficit due to transition costs associated with lost tax revenue. While the experience of the United States will not necessarily mirror that of other countries, these countries offer important lessons.

A recent World Bank report on the experiences in Latin America found that "more than half of all workers [are excluded] from even a semblance of a safety net during their old age" (Indermit Gill, Truman Packard and Juan Yermo, Keeping the Promise of Old Age Income Security in Latin America, 2004). This report also finds that retirees' private accounts are much smaller than predicted.

The World Bank data on the privatization experiences in Latin American countries reveal:

- Administrative costs (including commissions) of running private accounts are between 10 and 50 times as much as the administrative costs associated the with U.S. Social Security system. In Chile, an estimated one-quarter to one-third of a worker's contributions into a private account go to pay commissions.

- The cost of running a new public agency that would not replace the current Social Security Administration but would oversee the system of private accounts (i.e., a Securities and Exchange Commission-like agency) is between 62% and 400% of the costs of running the U.S. Social Security system.

- The cost of converting funds in private accounts into a lifetime annuity is between 11 and 22 times the cost of running the U.S. Social Security system. Again, these fees go directly to the financial services sector, instead of going toward an individual's private account. In Chile, the cost of purchasing an annuity has doubled over the past 10 years.

- The World Bank study on pension privatization in Chile has shown conclusively that workers place the greatest value in the guaranteed benefit portion of the system. After contributing the minimum amount necessary to qualify for the lowest guaranteed benefits, workers are much less likely to continue contributing to the pension system. When allowed to vote with their money, workers in Chile have expressed a strong preference for the social insurance aspects of the system —that is, the one most like the present Social Security system in the United States.

Based on the experience of other Latin American countries, these three types of costs, as well as the time workers will be required to spend managing their accounts each year, are estimated to cost the United States an additional $65 billion to $230 billion annually (Dean Baker and Debayani Kar of CEPR, Defined Contributions from Workers, Guaranteed Benefits for Bankers: The World Bank's Approach to Social Security Reform, July 2002).

Privatization in the United Kingdom provides a cautionary tale. Like proposals in the United States, the U. K. switched from wage to price indexing, which is expected to cut benefits almost in half within 30 to 40 years. In 1988, government legislation encouraged U.K. workers to opt out of the public system and invest in private accounts by (1) cutting replacement rates in the public system from 25% in 1999 to 20% in 2009, and (2) no longer basing benefits on the highest 20 years but instead on lifetime earnings. Britain's transition was marked by a "mis-selling scandal"—many workers were convinced to switch to private accounts, sometimes forfeiting generous employer pensions and at other times losing much of their retirement money due to fraud and bad financial advice from the private insurance companies they

relied upon. The administrative and management costs are high-on average, they have reduced pension account balances by up to 40% at retirement. There is also evidence that the switch increased inequality and lowered pension benefits for many low-wage workers and many women. Given all the problems, the U.K. insurance companies have been urging their customers to return to the state-sponsored system. In 2004 alone, 500,000 people left their private plans to return to the state system. As a result, many British officials are currently looking to the United States' Social Security system as a model for reform, and the most prominent U.K. business group has endorsed raising taxes to increase benefit levels.

For more information on international experience with privatization, see:

- Larry Rohter, Chile's Retirees Find Shortfall in Private Plan in *The New York Times*, January 27, 2005
- Norma Cohen, A Bloody Mess in *The American Prospect*, January 2005
- Indermit Gil, Truman Packard and Juan Yermo, Keeping the Promise of Old Age Income Security in Latin America, 2004
- Greg Anrig Jr. and Bernard Wasow, Twelve Reasons Why Privatizing Social Security is a Bad Idea (Reason #2), December 2004
- Social Security Administration, Social Security Programs Throughout the World, various years
- Dean Baker and Debayani Kar of CEPR, Defined Contributions from Workers, Guaranteed Benefits for Bankers: The World Bank's Approach to Social Security Reform, July 2002
- Steve Idemoto, Pension Privatization in Britain: A Boon to the Finance Industry, a Boondoggle to Workers, September 2000
- John Williamson, Social Security Privatization In Other Nations: Lessons For The United States, November 1999
- Congressional Budget Office, Social Security Privatization: Experiences Abroad, January 1999

[back to top]

Unlike privatization, there are alternatives that would address the long-term funding crisis.

Can Social Security be reformed without substantial benefit cuts?

Privatization, in and of itself, does nothing to address the long-term shortfall in the Social Security trust fund. In order to address the shortfall and strengthen Social Security, revenues must be raised, benefits must be cut, or both. The menu of options could potentially include:

Raising revenues by:

- raising the cap on taxable wages above its current level of $90,000, which covers 85% of all wages, to $140,000 (so that, as was legislated in 1983, 90% of all wages are taxed);
- removing the cap on taxable wages entirely, so that 100% of all wages are taxed;
- increasing the Social Security payroll tax rate above 12.4%;
- imposing a new, smaller payroll tax on all earnings above the maximum;
- instituting a special payroll tax when the fund balance, life expectancy, or some other trigger reaches a certain level;
- reinstating the estate tax; or
- transferring from general revenues/increasing borrowing.

Cutting benefits by:

- raising the retirement age to reflect changes in life expectancy;
- changing from wage indexation of benefits to price indexation for some or all earners;
- changing the consumer price index (CPI) from the current measure (CPI-Wages) to a "superlative CPI" that the Labor Department has developed; or
- lowering the initial benefit to index for increasing longevity.

Other options that would improve solvency include:

- covering all new state and local employees under the Social Security system (similar to when the federal government was brought into the Social Security system in 1983);
- increasing the number of years of earnings that are considered from 35 to, e.g., 38; or
- allowing a portion of the current trust fund to be invested in a stock index fund.

Variations of these changes could be progressive (and help low-wage workers) or regressive (and favor higher-wage workers).

For a more detailed discussion on the various options, see:

- Bill Spriggs, Top earners get Social Security windfall, others get the bill, EPI, March 9, 2005
- Virginia Reno and Joni Lavery, Options to balance Social Security funds over the next 75 years,

National Academy of Social Insurance, February 2005

- Josh Bivens, Removing the Social Security earnings cap virtually eliminates funding gap, EPI, February 17, 2005
- Memo from Chris Chaplain and Alice Wade to Stephen Goss, Social Security Administration, Estimated OASDI long-range financial effects of several provisions requested by the Social Security Advisory Board-information, February 7, 2005
- William Dudley, Jan Hatzius, and Edward McKelvey, Thoughts on Social Security Reform, Goldman Sachs Global Economics Paper No. 120, January 18, 2005

A number of specific alternatives to privatization—which favor raising revenues and limited benefit cuts—have been proposed. Three plans are described briefly below.

American Association of Retired Persons' Plan. The American Association of Retired Persons (AARP) has explicitly supported a number of steps to address the future Social Security shortfall. These include investing up to 15% of the trust fund in the market so that it earns higher returns than U.S. Treasury bonds; gradually raising the cap on the amount of wages taxed to approximately $140,000; and including all newly hired state and local government workers under Social Security. While these three steps alone do not address the entire shortfall, they do narrow the gap. The AARP opposes private accounts that are financed using the Social Security payroll tax; however, AARP endorses the use of private retirement accounts in addition to Social Security (Merrill Goozner, Don't Mess with Success, January 2005; AARP, Our Fight: Keeping Social Security Strong, 2004).

Robert Ball's Plan. Robert Ball, the founding chair of the National Academy of Social Insurance, has proposed a plan to fix Social Security that was the basis of a bill introduced in 2004 by Representative David Obey (Robert Ball, How to Fix Social Security? It Doesn't Have to be Hard in Aging Today, 2004; Social Security Solvency Act of 2004-H.R. 5179). Today, Social Security payroll taxes are assessed on wages up to $90,000, which covers 85% of earnings. The Ball Plan would increase revenue by covering 90% of all earnings (i.e., the level expected at the time of the last major changes in Social Security resulting from the previous Social Security Commission headed by Alan Greenspan and enacted by Congress in 1983) and keep it at that level. It would also include an estate tax (exempting estates up to $3.5 million) with its revenues dedicated to Social Security, and introduce a new, automatic "balancing rate" tax when trust fund balances start to decline (roughly 2055). The only tweak to benefits would be the incorporation of a slightly less-generous consumer price index for inflation protection once benefits begin.

Diamond-Orszag Proposal. Peter Diamond and Peter Orszag have a proposal (Peter Diamond and Peter Orszag, Saving Social Security: A Balanced Approach, Brookings Institution Press, 2003) that was recently scored by the Congressional Budget Office. (CBO, Long-term Analysis of the Diamond-Orszag Social Security Plan, December 22, 2004). The Diamond-Orszag proposal would increase the Social Security payroll tax rate; raise the amount of earnings subject to the standard payroll tax; initiate a new, lower payroll tax on earnings above the maximum; reduce benefits for retirees and disabled beneficiaries in 2012 and later;

increase benefits for workers with low lifetime earnings and surviving spouses; and cover all state and local government workers. CBO compared the Diamond-Orszag proposal to current law and found that:

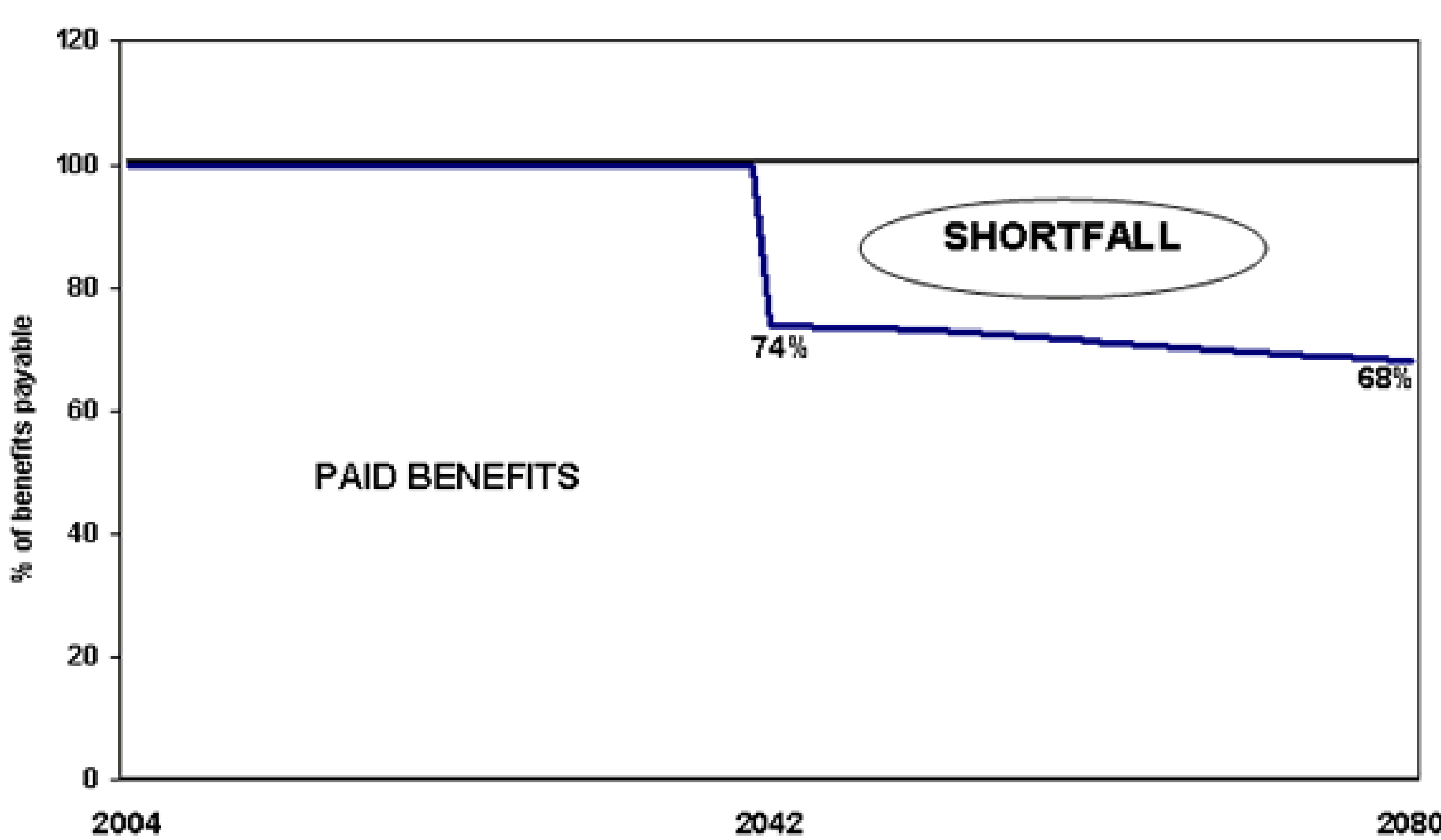
- revenues would be higher under the Diamond-Orszag proposal than current law;
- scheduled benefits would be the same under the Diamond-Orszag proposal and current law for the next 40 years and much higher than under Plan 2;
- higher-paid workers would face larger tax increases and larger benefit reductions, while lower-paid workers would be sheltered from benefit reductions and some would be better off; and
- the trust fund balance would always be positive under the Diamond-Orszag proposal, but is scheduled to exhaust in 2052 under current law.

[back to top]

ECONOMIC POLICY INSTITUTE

EPI ISSUE GUIDE

Social Security



ECONOMIC POLICY INSTITUTE

EPI ISSUE GUIDE

Social Security

Changes in trustees' projections over time

Trustee report date	1996	1997	1998	1999	2000	2004
Year when tax revenue falls short of benefits	2012	2012	2013	2014	2015	2018
Year when trust fund income falls below expenditures	2019	2019	2021	2022	2024	2028
Trust fund depletion date	2029	2029	2032	2034	2037	2042
Shortfall as a share of taxable payroll	2.19%	2.23%	2.19%	2.07%	1.89%	1.89%

Source: Annual Reports of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds, 1996-2004.