



Social Security for the 21st Century

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I. INTRODUCTION

Social Security is one of America's great successes. The program provides a foundation of economic security for more than 47 million Americans and their families. Because of Social Security's built-in protections, we have come close to eliminating poverty among seniors. Social Security also provides basic income to millions of families who have suffered the death or disability of a wage earner.

Social Security is financially strong. In 2003, Social Security took in \$161 billion more than it paid out in benefits. The program has the resources to provide benefits for the baby boomers and their children and grandchildren. The Social Security Trustees predict that Social Security will pay ever-increasing benefits through at least 2042, when surviving baby boomers will be mostly in their 80s and 90s. If the United States economy's long-term growth rate falls to half the level of the past 50 years, the Trust Fund may be depleted after 2042, but Social Security payroll taxes alone would still cover benefits worth an estimated \$1,100 more after inflation than today's seniors receive. Using less pessimistic economic assumptions, the Trustees' low-cost long-term forecast predicts that Social Security will continue to provide each generation of retirees with more generous benefits than their predecessors through the entire 21st century.

If Social Security finances are really in good shape, why have so many politicians, policy analysts, and reporters warned us that something must be done to "save" Social Security? How have so many Americans become convinced that Social Security won't be there for them?

Misconceptions about Social Security are widespread because predictions about the distant future based on multiple assumptions are reported as "facts," frequently distorted, and almost always considered out of context. In addition, some organizations and individuals committed to privatizing Social Security are driven by ideology or hope of profiting from the billions of dollars in investment fees that a privatized system could generate. The majority of Americans would be worse off financially under a privatized system, all would be far less secure, and creating a new system would cost trillions of new tax dollars. Therefore, undermining faith in the existing Social Security program has been a major strategy privatizers have used to promote their agenda.

This report provides background information on how Social Security works, explains how it is that Americans can easily afford Social Security in the long run even as our population ages, and points out fundamental problems with proposals to privatize the program. Finally, it recommends ways we should improve Social Security to serve Americans even better.

II. WHAT IS SOCIAL SECURITY?

In 2003 Social Security provided \$471 billion in benefits to 47 million people, one out of every six Americans. An additional 154 million people are working in jobs covered by Social Security's protections, and millions more have a family member who is a Social Security beneficiary.⁰ In Washington state, more than 873,000 of our 5.9 million residents receive Social Security payments totaling \$9 billion each year.¹

While we most often think of Social Security as a retirement program, 30% of beneficiaries collect survivors or disability insurance.

Social Security survivors insurance provides benefits to the families of deceased workers, including children under age 18, 18 and 19-year-olds still in high school, disabled sons or daughters of any age, elderly dependent parents, and surviving spouses who are elderly, disabled, or caring for eligible children. For a widow with two children, the average monthly benefit in 2004 is \$1,900.² Ninety-seven percent of American children are insured by survivors benefits.³

Social Security disability insurance covers disabled workers, their spouses, and their children.⁴ The average benefit for a disabled worker with a spouse and a child is \$1,442 per month.

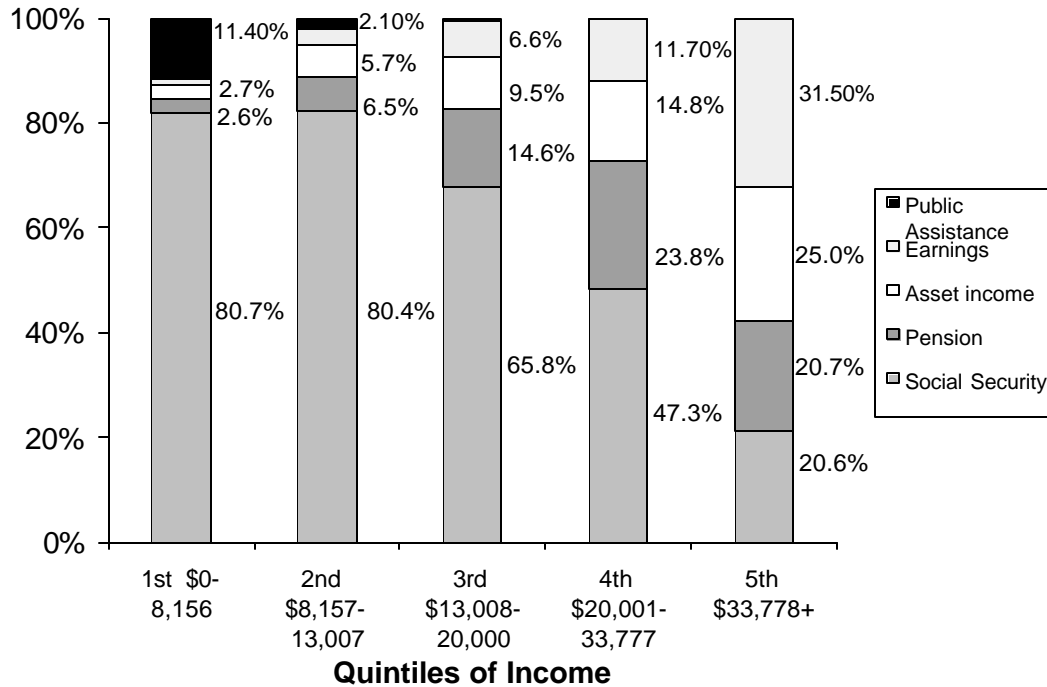
Social Security's survivors and disability insurance is particularly important to younger workers and their families.

- The Social Security Administration estimates that of today's 20-year-olds, 3 out of 10 will become disabled and 1 out of 7 will die before reaching retirement age.
- For a young married worker with two children, Social Security provides the equivalent of a \$403,000 life insurance policy *and* a \$353,000 disability policy.⁵
- More children live in families supported by Social Security insurance than by Temporary Assistance to Needy Families (TANF, or welfare). Three million children under age 18 are Social Security beneficiaries themselves, and another 2.2 million children live with a family member on Social Security, compared to 4 million children in families that received TANF in 2001.⁶

Social Security provides lifetime retirement benefits for retirees who have worked at least ten years, their spouses, and dependents. For the past 60 years, workers have been eligible for full benefits at age 65, but under a Reagan-era law, the full retirement age began gradually rising in 2003.⁷ For workers born in 1960 or later, the full retirement age will be 67. Those who choose to retire between age 62 and their full retirement age can receive benefits at a reduced rate, and those who postpone retirement become eligible for increased monthly benefits. The average retiree's benefit is \$922 per month for an individual and \$1,523 for a couple.⁸ Husbands and wives can choose to either each collect benefits based on their individual earnings or collect a couple's benefit of 1.5 times the higher earner's benefit.

Middle-income retirees receive almost two-thirds of their income from Social Security. For two-fifths of our elderly, Social Security provides over 80% of income, and it is the only source of income for 25% of elderly unmarried women, including widowed, divorced, and never-married women.⁹

Percent of Income by Source for Senior Households, by Quintiles of Income



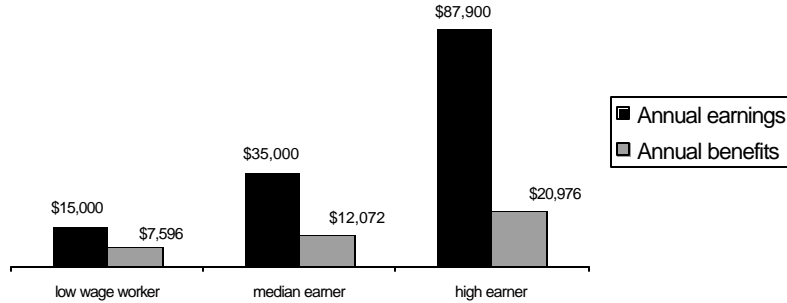
Source: Social Security Administration, *Income of the Population 55 or Over*, 1996.

How Social Security Works: The Benefits of Social Insurance

Social Security is an insurance program, not an investment plan. Payroll taxes of today's workers pay for the benefits of today's recipients. Employees and employers each pay 6.2% of wages below \$87,900 (in 2004). High-earning workers and their employers do not pay Social Security taxes on income above this earnings cap, which changes annually with average wages. An additional 1.45% of wages is collected from both employer and employee to pay for Medicare's Hospital Insurance. There is no earnings cap for Medicare. Social Security and Medicare taxes are not collected on unearned income such as capital gains and interest.

Social Security's benefit structure recognizes the dignity of all work and the importance of family; it protects people from poverty in old age and times of crisis. While Social Security's taxes are regressive, falling hardest on those with lowest incomes, the benefits are progressive, especially benefiting the most vulnerable. People who spend a lifetime in low-paying jobs receive a higher percentage of their former wages in benefits than do people who earned high wages. A childcare teacher retiring in 2005 who earned \$15,000 annually would typically receive an annual Social Security income of \$7,596 or 51% of working income. An administrative assistant earning \$35,000 would receive benefits of \$12,072, replacing 34% of working income, and a university professor earning \$87,900 would receive \$20,976 or 24%.¹⁰

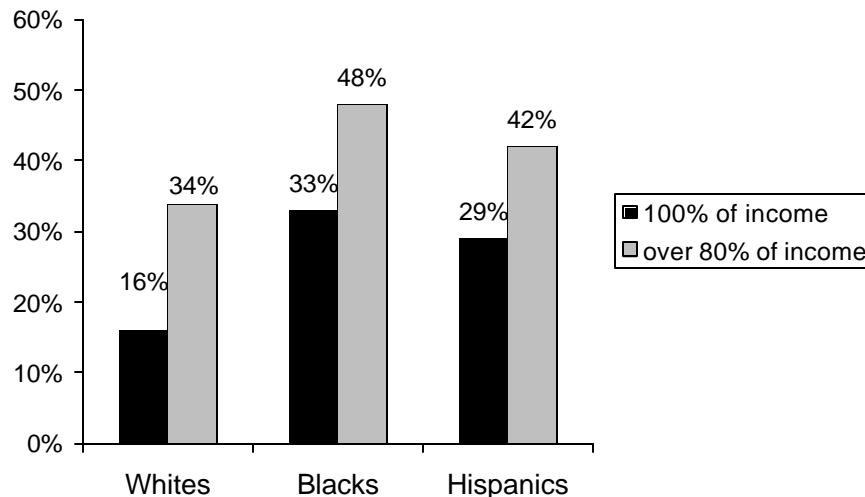
Typical Social Security Benefits for Low, Middle, and High Earners



Source: Social Security Administration, Benefit Calculator, www.ssa.gov.

People who earn higher incomes typically not only have far more opportunities to save during their working years but also are more likely to be in jobs covered by workplace retirement plans to supplement their Social Security income. Progressive benefits make Social Security a particularly valuable program for women, African-Americans, and others who often have lower than average lifetime earnings and less access to pensions or other workplace benefits.¹¹

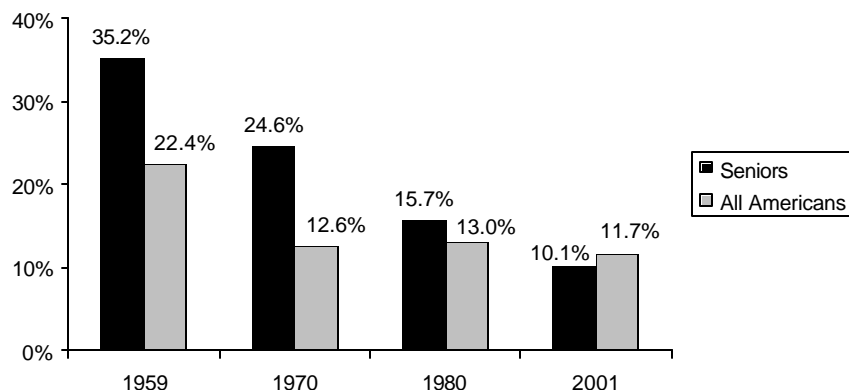
Percentage of Senior Households with Social Security as Primary Income



Source: Social Security Administration, *Income of the Population 55 or Over*, 1996.

Congress has amended Social Security taxes and benefits many times since the program was enacted in 1935. The addition of annual cost-of-living adjustments (COLAs) in 1972 has significantly reduced poverty among seniors, particularly women.¹² At age 65, a man can expect, on average, to live to age 81 and a woman to age 84. About 17.5% of men and 31.4% of women who reach age 65 will live past 90.¹³ Because of COLAs, the guarantee of lifetime retirement benefits, and the provision of survivors benefits to widows and widowers, poverty among seniors has dropped below the rate for the general population. In contrast, in the mid-20th century over one-third of the nation's seniors lived in poverty.¹⁴

Poverty Rates for All Americans and Those 65 and Older



Source: U.S. Census, Historical Series

Some have argued that because African-American men have lower life expectancies than white men, they lose out with the current system. However, the life expectancy differences between white and black men are mostly due to a higher rate of early deaths among blacks. African-American men who reach age 65 will live, on average, to age 79, only two years less than white men.¹⁵ African-American families also benefit from progressive benefits and are especially reliant on Social Security's other insurance protections. While African-Americans comprise 12% of the U.S. population, 17% of disabled workers receiving benefits and 23% of children receiving survivors benefits are black.¹⁶

Another advantage of Social Security's structure is that it is efficient to administer. Total administrative costs in 2003 were under 1% of benefits.¹⁷

Social Security is essential to the economic security of all Americans. Because Social Security is an insurance program that shares risks broadly across the whole population, it can provide benefits to those who need them most. We know that some people will live well beyond average life expectancies, to age 90 or 100 and beyond. We know that some people will die as young adults, leaving behind children and spouses who relied on their income. We know that some people will become too disabled to work well before the usual retirement age, and some retirees will find themselves unexpectedly caring for their grandchildren. But it is impossible to predict in advance which individuals will meet these fates. Social Security's ability to respond with benefits in all these situations is what makes it so essential to the economic security of all Americans.

III. THE FUTURE OF SOCIAL SECURITY

In 2003, Social Security took in \$161 billion more than it paid out in benefits. Economists project that in 70 years when the children of today are retired, they will receive higher benefits than their grandparents are getting. Yet for years we have been hearing about the "crisis" facing Social Security. The notion of "crisis" has its seeds in the 75-year projections of the Social Security Trustees and fears about an aging

population. Taken out of context, the situation can look alarming, and it is nearly impossible to put the context into a sound bite. But Social Security is too important a program for Americans to be so thoroughly misinformed.

The Trustees' Reports and the Social Security Trust Fund

Every spring the Social Security Trustees issue a report that projects the income and expenses of Social Security for 75 years into the future.* The projections require numerous assumptions about birth rates, immigration rates, unemployment, average wages, life expectancy, and the like. Over 75 years, small differences in assumptions can result in large differences in outcomes. The Trustees make three different projections based on different assumptions. These three scenarios are called the low-cost, intermediate, and high-cost projections.

Following the recommendations of a commission chaired by Alan Greenspan, Social Security has been collecting extra payroll taxes since 1983 to prepare for the retirement of the baby boom generation. According to the 2004 Trustees' report, in 2003 workers paid \$63 billion more in payroll taxes than were paid out in Social Security benefits. Social Security also received \$85 billion in interest on the Trust Fund and \$13 billion from income taxes that some higher-income recipients pay on a portion of their benefits.¹⁸ This extra money goes into the Trust Fund, which now exceeds \$1.5 trillion. The Trust Fund is deposited in Treasury bonds and earned 6% interest in 2003.

The Trustees' *intermediate* projection predicts that Social Security payroll taxes will continue to exceed benefits until 2018, and the combination of taxes and interest on the Trust Fund will cover benefits until 2028. Between 2028 and 2042, new Social Security revenues plus Trust Fund assets will allow payment of all expected benefits. After 2042 according to this scenario, the Trust Fund assets would be used up and payroll taxes would cover about 73% of expected benefits, gradually declining to 68% of benefits over the rest of the century.

The Trustees' *low-cost* projection with slightly different assumptions predicts that the Trust Fund will never be exhausted and the program will always have the resources to pay full benefits without any changes in the tax rate or benefit formula. The *high-cost* projection predicts that the Trust Fund will be used up a decade sooner.

The Social Security actuaries use the alarming sounding term "insolvency" to indicate that the program may not have the resources to pay *all* its obligations at some point in the future. However, under every projection Social Security will always have the resources to meet *most* of its obligations.¹⁹ Should we be worried? The short answer is no. The longer answer includes these points:

- The Trustees' projections are predictions of the future and are at most possibilities, not certainties.
- The intermediate and high-cost scenarios are based on extremely pessimistic assumptions about our future economy. Even the low-cost scenario assumes the economy will grow much more slowly in the future than in the present or past.

* The Trustees include the Secretaries of Labor, Treasury, and Health and Human Services, the Social Security Commissioner, and two other members appointed by the President.

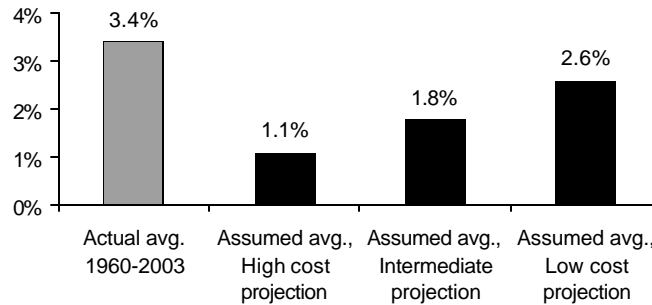
- All of the forecasts, gloomy though they are, also project that workers and Social Security beneficiaries in future decades will have higher incomes after controlling for inflation than people have today.
- By any measure, we will be able to "afford" Social Security, even with all the baby boomers retired and everyone living longer.

Predicting the future: In the 1970s Social Security did face an actual crisis. Benefit payments exceeded income beginning in 1975, and the 75-year projection showed the program always in the red. But Congress raised payroll taxes and made other changes, many of them recommended by the Greenspan commission. In 1983 the Trustees reported that Social Security looked financially healthy for 75 years. By 1993, the Trustees had made changes in their assumptions and methodology for forecasting the future and predicted a possible shortfall in 2036. In 1997, the Trustees intermediate scenario projected a shortfall would occur beginning in 2029. Since then, the date of possible shortfall under the intermediate forecast has been gradually pushed back to 2042.²⁰

Predicting the future is a perilous exercise. In their 2001 report, issued on the eve of the recession, the Trustees predicted that the economy would grow by 3.1% that year. Instead, economic growth for the year only reached 0.3%. More cautious the following year, the Trustees predicted that 2002 economic growth would only reach 0.7%, but instead the economy grew by a respectable 2.4%. Of course, like the weather, one could expect averages over time to be more predicable than a single year's experience. Still, it is nearly impossible to predict the cumulative impact of technological innovations, global climate changes, international developments, and demographic changes decades into the future.

Pessimistic forecasts: One key variable that incorporates many economic trends is the rate of economic growth or the annual percentage increase in the Gross Domestic Product (GDP). Since 1960, GDP growth has averaged 3.4% each year. For the entire 20th century, including the Great Depression of the 1930s, annual GDP growth averaged over 3%. Even the very sluggish economy of 2002 grew by 2.4%. Despite past experience, the Trustees' intermediate projection assumes that economic growth will decline over the next decade and will only average 1.8% annually from 2015 to the end of the century. The low-cost estimate, which projects that Social Security's current financing structure will always meet full benefits, assumes a long-term average growth in GDP of 2.6%, a cautious but more reasonable assumption based on long-term experience.

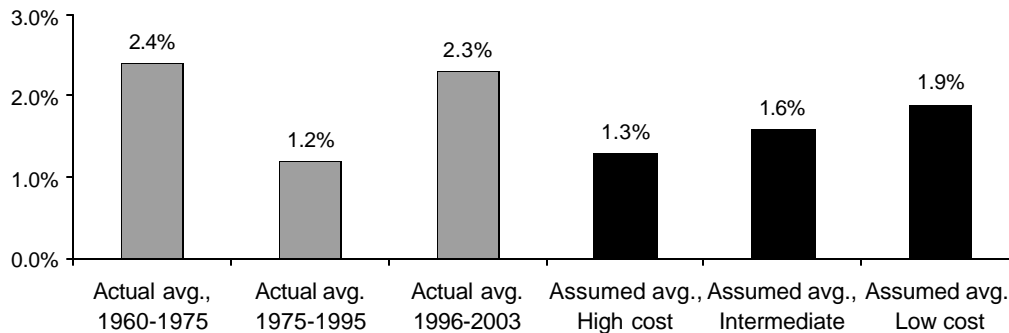
Average Annual GDP Growth Assumed in Social Security Trustee Projections



Source: Social Security Trustees Annual Report 2004

A key variable affecting GDP growth is productivity growth. Over time, because of technological change and other innovations, each worker is able to produce more. One of the reasons the Trustees' forecasts became so pessimistic in the 1990s was that between 1975 and 1995 productivity grew at much slower rates than it had in earlier decades. Since 1996, productivity levels have risen back to previous levels. All three of the Trustees' long-term forecasts assume rates of productivity growth above the low levels of the 1980s and early 1990s but below more recent and historical levels.

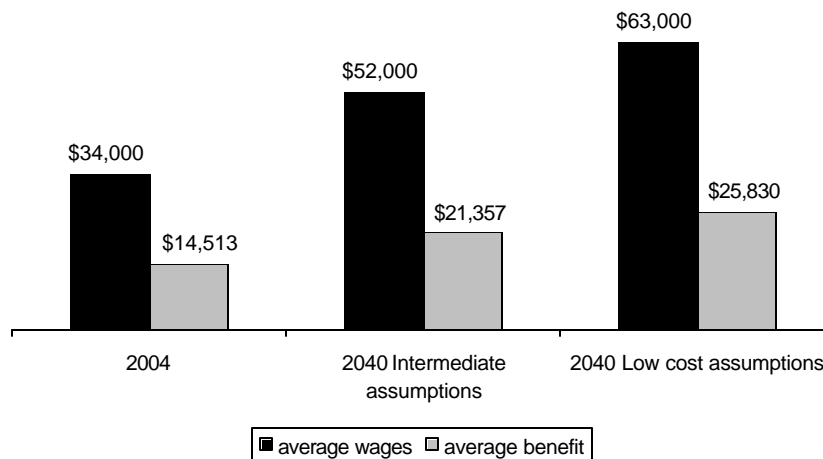
Average Annual Growth in Productivity Assumed in Social Security Trustee Projections



Source: Social Security Trustees Annual Report 2004

Rising incomes: One of the benefits of productivity growth for the typical worker is that it pushes wages up a little faster than inflation and allows general living standards to gradually rise. Social Security benefits also go up along with average wages. (Once someone starts getting benefits, those benefits are increased each year at the rate of inflation rather than the rate of average wage growth.²¹) Even under the pessimistic assumptions of the intermediate forecast, workers and Social Security recipients will have considerably higher incomes after adjusting for inflation in future decades than Americans have today. Using the slightly more optimistic low-cost assumptions, the real buying power of both workers and Social Security recipients will go up even more in coming decades.²²

Projected Average Wages and Benefits, in 2004 Dollars, Under Intermediate and Low-Cost Scenarios



Source: Social Security Trustees Annual Report 2004

It is important to keep rising incomes in mind when considering future scenarios. If the Trustees' intermediate forecast turned out to be precisely accurate and if Congress undertook some combination of raising the payroll tax cap, increasing Social Security taxes, or cutting benefits in 2042, both workers and retirees would still have considerably more buying power than they do today. If Congress simply cut benefits in 2042 to 73% of the promised level in order to stay within projected revenues, the average retiree would still have \$1,100 more annually after adjusting for inflation than the average retiree in 2004.

"Affording" Social Security

We will certainly be able to afford Social Security in coming decades, although as most people intuitively grasp, Social Security will cost more when the baby boom generation has all retired and people are living longer. The contention, made by some, that we cannot any longer "afford" Social Security usually rests on these factors:

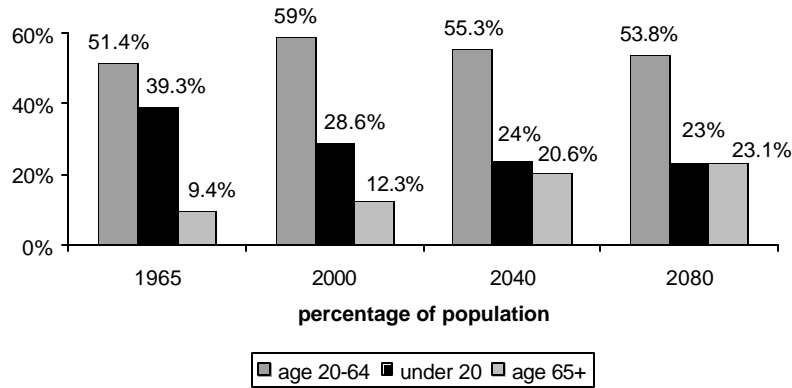
- In 2003, there were 3.3 workers for every Social Security beneficiary. That number will drop to 2.2 in 2030, then decline very slowly after that.
- The cost of Social Security will increase from 4.3% of our total economy or GDP to 6.3% in 2030 and 6.6% in 2078, about a 50% increase.

The situation can sound scary taken out of context, but when the whole picture is considered, it becomes obvious that Americans will continue to be able to afford Social Security.

How can fewer workers support more retirees? Fewer workers will be able to support more retirees in future decades in large part because of productively growth, the same way that far fewer farmers can feed us today than 75 years ago. Future workers will also be supporting fewer children. In fact, at no point during the 21st century will workers have to support as many dependents as American workers did during the 1960s

and 1970s. The Trustees' report predicts that throughout the 21st century the percentage of the population of working age will remain well above the level of the mid-20th century.

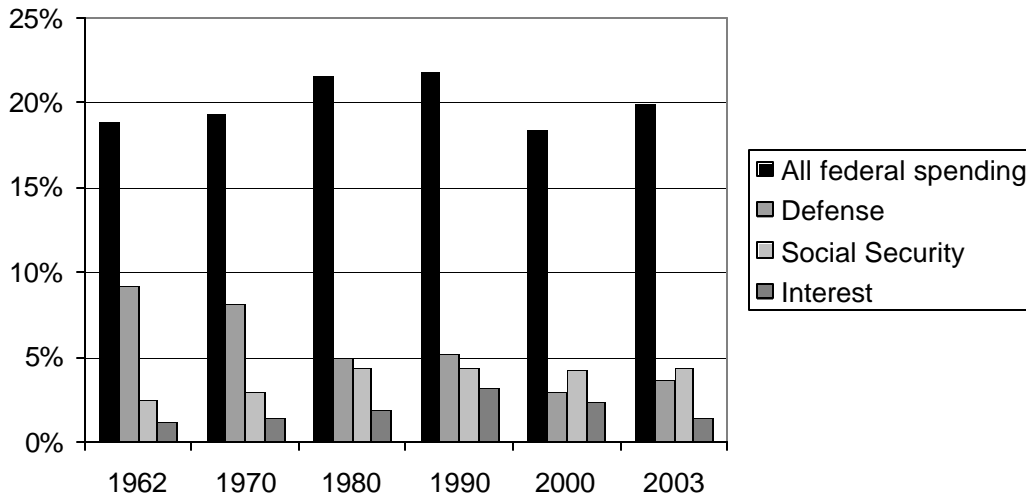
Percent of Population by Age, In Trustees' Intermediate Forecast



Source: Social Security Trustees Annual Report 2004

Social Security and government spending: The cost of Social Security may increase from 4.3% of GDP to 6.3% in 2030 and to 6.6% in 2078, but that's still only 2% of our total economy. Spending on Social Security also increased by 2% of GDP during the decade of the 1950s (when it grew from 0.3% to 2.2%), and again between 1960 and 1980 (when it increased from 2.2% to 4.3%).

Federal Spending as a Percent of Gross Domestic Product



Source: Congressional Budget Office

Looking at the overall picture of changes in federal spending since the 1960s, it is clear that an increase of 2% is well within our national capabilities. Total federal spending actually dropped by 3.5% from its high point of 21.8% of GDP in 1990 to 18.4% in 2000 and has risen again by 1.5% since George W. Bush took office. The projected 2%

increase in Social Security will merely return total federal government spending near to the level that prevailed from the 1970s through the mid-1990s. Looked at another way, in future decades Social Security will cost about what that program plus interest on the national debt cost today.²³

But is the Trust Fund real? A frequently raised concern is that the government is spending the Trust Fund instead of saving it. By law, the Trust Fund is invested in U.S. Treasury bonds, generally considered by investors to be the safest investment in the world. While the stock market crashed in 2001, the Social Security Trust Fund continued to steadily earn interest at a rate of over 6%, totaling \$73 billion in that year. Certainly the government does not have a vault somewhere with bags of cash piling up, anymore than banks keep each depositor's savings in a separate cubbyhole. Rather, the Trust Fund gets reinvested back into the American economy. At its most effective, it is invested in Head Start, basic research, college loans, public transit systems, highways, environmental cleanup, and other ways that provide widespread opportunity and make the future workforce more productive. These investments in the American people and the nation's infrastructure will help keep our economy and Social Security healthy.²⁴

According to forecasts, during the 2030s the Social Security Administration will have to redeem its Treasury bonds to augment payroll taxes and cover benefits. Redeeming the bonds would be easier if the federal government did not have large amounts of other debt and, consequently, large interest payments as well. That is why the policies of the Clinton administration to maintain a federal surplus and pay off the national debt made sense as a way to keep faith with Social Security's promises. In contrast, the Bush administration's policy of running large deficits and using the current excess in Social Security payroll taxes to pay for tax cuts for the wealthiest Americans does undermine the government's ability to meet many of its responsibilities. Nevertheless, the Social Security system is strong enough to withstand a period of poor policy choices.

The percentage of the population that will be of working age in future decades, the higher incomes those workers will enjoy, and the percentage of our total national economy that will be required to support Social Security all lead to the same conclusion: Americans will easily be able to afford Social Security for future generations.

Sidebar: Overpriced Health Care and the Rising Costs of Medicare

The Social Security Trustees also oversee Medicare, which provides health insurance for 41 million senior and disabled Americans.²⁵ While the cost of Social Security is expected to level off after 2030, the trustees project that Medicare's costs will continue to rise from 2.3% of GDP in 2003 to 7% in 2030 and 13.8% in 2078. Medicare's Hospital Insurance Trust Fund may be exhausted as soon as 2019.²⁶ While Social Security's long-term finances are healthy, Medicare's appear considerably shakier. Nevertheless, Medicare's costs have no direct effect on the long-term health of Social Security. Although the two programs are sometimes lumped together by commentators, their funding and operations are separate.

Medicare's costs are expected to go up much faster than Social Security's because medical costs are skyrocketing. We cannot solve the Medicare problem without fixing the underlying problems that make our entire health care system too expensive.

The United States has the most expensive health care system in the world. We spend 50% more of our economy on health care than most of Western Europe, yet we have higher rates of infant death and shorter life expectancies than more than 20 other countries. We spend nearly 14% of GDP on health care. Switzerland and Germany are the two next highest spending countries, at around 11%. Most other highly developed countries spend between 8% and 10% of GDP on health care. Japan has the longest life expectancies in the world and close to the lowest infant deaths, yet spends only 8% of its GDP on health care. The American government also spends more on health care than any other government in the world, even though our citizens pick up so much of the tab.²⁷

Spending on Health and Health Outcomes in the United States and Selected Other Countries, 2001

Country	Health spending as % of GDP	Health as % of all government spending	Private spending as % of all health spending	Life expectancy at birth in 2002	Deaths before 5 per 1000
United States	13.9	17.6	55.6	77.3	8
Switzerland	11	13.2	42.9	80.6	5.5
Germany	10.8	16.6	25.1	78.7	4.5
France	9.6	13.7	24	79.7	4.5
Canada	9.5	16.2	29.2	79.8	5.5
Greece	9.4	11.2	44	78.4	6
Australia	9.2	16.8	32.1	80.4	5.5
Sweden	8.7	13	14.8	80.4	3.5
Japan	8	16.4	22.1	81.9	4
United Kingdom	7.6	15.4	17.8	78.2	6.5
Mexico	6.1	16.7	55.7	74.4	27

Source: World Health Organization, *World Health Report 2003, Annex Tables 1 and 5.*

As a result of high costs and the lack of universal coverage, unemployed and low-income workers have little choice but to drop health insurance. American businesses have a hard time maintaining benefits and competing in the international marketplace.²⁸ State and local governments are reeling from the rapidly rising costs of providing health insurance to school teachers, government workers, low-income children, and low-income workers.²⁹

A number of factors contribute to the extraordinarily high cost of U.S. health care, including skyrocketing drug prices, enormous drug company profits, and vast for-profit insurance bureaucracies. But the main cause of both high costs and poor outcomes is

the hodgepodge of insurance arrangements that resulted in 70 million Americans being left uninsured for some part of 2002.³⁰

These problems affect the health care of all Americans. They also hurt the long-term health of our economy. We will not solve the problems with Medicare if we define the problem as within the Medicare system or as being caused by the aging of the baby boomers. Our whole health care system is unsustainable and needs a thorough overhaul.

IV. CHOICES FOR MAKING SOCIAL SECURITY EVEN BETTER

The inevitable conclusions from a look at the total picture of Social Security's history of success and its future finances are:

1. Social Security provides a foundation of economic security to working and retired Americans and their families.
2. Social Security's short-term finances are in excellent shape.
3. Social Security's long-term finances will most likely be solid.
4. In the event that economic growth is as sluggish as the Trustees' intermediate forecast predicts over the next two decades, there will be ample time to consider modest adjustments to Social Security's funding stream or benefit formula. Simply eliminating the cap on taxable income would bring in close to all the additional revenue necessary to maintain full, rising benefits under the intermediate scenario.³¹ The percentage of workers whose full wages are taxable has decreased over the past two decades because top earners have seen their incomes soar while low and middle earners have received only modest or no increases.³² Eliminating the cap on taxable income would also lessen the regressive nature of Social Security taxes.

Privatization: The Wrong Choice for Americans of All Ages

For many years conservative organizations such as the Cato Institute and the Heritage Foundation have promoted an ideological agenda to privatize Social Security.³³ Because transforming Social Security into 200 million individual accounts would generate billions of dollars in investment fees and result in a windfall of profits for Wall Street, financial interests with much to gain have joined in heavily promoting the privatization agenda. President Bush has repeatedly endorsed the notion of privatizing Social Security, and in 2001 he appointed a commission of privatization supporters to come up with a plan.

The President's Commission to Strengthen Social Security developed three alternative plans for partial privatization in December 2001. Each of the commission's alternatives included both a significantly reduced guaranteed benefit and a parallel system of individual accounts formed by diverting a portion of each worker's payroll tax. The

commissioners proposed making the individual accounts voluntary, but their plans reduced guaranteed benefits for all future Social Security recipients, even those who chose to keep all their payroll taxes in the traditional system.³⁴

The commission's proposals were never seriously considered. The September 11th attacks and war on terrorism distracted attention, while the crash of the stock market and widespread corporate scandals lessened the appeal of individual investments for many voters. More importantly in the long run, detailed analyses of the commission's proposals showed that any one of them would result in lower incomes for most retirees, reduced benefits for disabled workers and survivors, and far less certainty for all Americans. In addition, funding benefits to current Social Security recipients while workers' payroll taxes were diverted into individual accounts would require between \$1 trillion and \$3 trillion in new taxpayer money.³⁵

While the commissioners claimed that on average workers would be able to do about as well or slightly better with a lower guaranteed benefit plus returns on their private accounts, many Americans would fare worse. Economists Peter Diamond and Peter Orszag calculated that a typical couple retiring in 70 years would have between 20% and 40% less income under the commission's proposals than under the current Social Security system.³⁶ Workers who lost time in the workforce because of family care, disability, or unemployment or who earned persistently low wages would have no chance to accumulate enough to make up for the loss in guaranteed and progressive benefits. Workers who died prematurely leaving young families would not have accumulated much in private accounts, yet survivors benefits would be slashed. Workers who happened to live through prolonged economic downturns would see major losses in their private accounts and would consequently face retirement with far lower incomes. And seniors who lived beyond the expected lifespan could spend their last decades in poverty unless all retirees were required to buy costly annuity plans which would further reduce their incomes while enriching private investment interests.

Privatizing Social Security would guarantee that millions more elderly, disabled workers, and children would live in poverty in future generations.

- Social Security's progressive benefits, annual COLAs, family benefits, and lifetime retirement benefits insure economic security to people in a broad range of life circumstances. In contrast, with individual investments the more someone earns, the more they accumulate. People who suffer early disability, spend time caring for children or parents, earn low wages, live extraordinarily long, or have large families would be worse off with private accounts.
- Women, who typically earn less, live longer, and take more time out of the workforce to care for family, are especially likely to fare worse under a system of private accounts than with Social Security.³⁷
- Many African-Americans and other minorities, who often earn less and rely disproportionately on the disability and survivors programs, will also lose out financially from a privatized system.³⁸
- Half the workforce continues to have no workplace retirement plan. Most workers who do have retirement plans now have programs like 401(k)s, which make retirement incomes highly dependent on the ups and downs of the stock

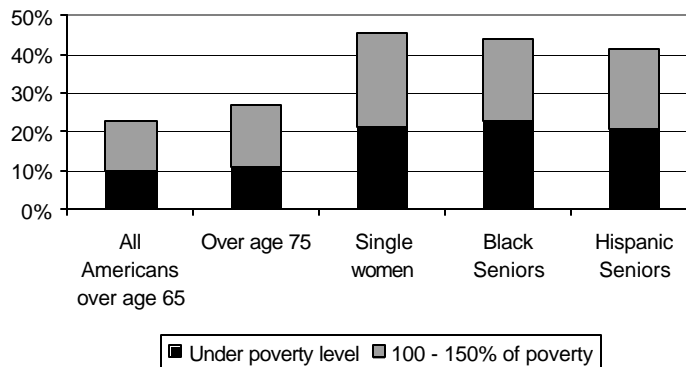
market. As fewer and fewer workers retire with fixed-benefit pensions, the stable base of Social Security's guaranteed, inflation-adjusted benefits will be all the more crucial in the future.³⁹

- Recent demographic trends make it even more important to keep Social Security structured as a social insurance program. Longer life spans, fewer children per family, and a high divorce rate mean that more very elderly people will rely entirely on Social Security in the future without the potential backup support of family members.
- The transition from the current pay-as-you-go system to a partially privatized system would cost trillions in new tax dollars.

The Right Reforms for Social Security

While Social Security has succeeded in assuring economic security to millions of American families, the program could be made even better. Social Security has reduced poverty among seniors to about 10%, but the rate of poverty is twice as high among widows and other single women, African-Americans, and Hispanics. Moreover, all too many seniors live just above the poverty line.⁴⁰ If we accept the truth that Social Security's finances are strong rather than buying into the rhetoric of crisis, we can begin addressing the very real problems of today rather than possible problems in the distant future.

Percentage of Seniors In and Near Poverty, 1999



Source: U.S. Census Bureau, "Poverty in the United States, 1999," September 2000.

We can achieve the goal of eliminating poverty and near poverty among Social Security recipients with several steps:

1. **Changing the benefit formula to increase benefits for the lowest income earners.** In 2004, Social Security recipients receiving a full benefit get 90% of the first \$612 of their average monthly earnings, 32% of earnings between \$612 and \$3,689, and 15% of higher earnings up to the maximum earnings base of \$7,325 monthly. (The wage amounts change each year with average wages.⁴¹) Some women's organizations have proposed replacing 100% of wages below the first "bend point" and 45% below the second and also lowering the second bend point.

This proposal would boost the incomes of those who need it the most with only a small increase in total costs.⁴²

2. **Increasing elderly survivors benefits.** Currently elderly widows and widowers lose one-third to one-half of the Social Security benefit that the couple had received. Raising the benefit for a surviving spouse to 75% of the couple's pre-death benefit with an income cap to limit the benefit for the highest income recipients would help low and moderate-income widows and widowers. This change would also redress an inequity that now exists between one and two-earner families.⁴³
3. **Providing family care credits.** Social Security benefits are based on the adjusted average of a worker's 35 highest-earning years. However, while men average 44 years in the workforce, women spend far more time providing unpaid family care and average only 32 years of paid work. Any years under the 35-year threshold are counted as zeros in the Social Security formula, lowering the typical woman's benefit. Fewer women would live in poverty in their old age if the formula were adjusted for time spent in family caregiving.⁴⁴
4. **Eliminating the cap on taxable income.** Earnings above \$87,900 (in 2004) are exempt from Social Security tax. Even though that cap is adjusted annually with average wage growth, a smaller percentage of wages is subject to Social Security taxes than 20 years ago because of the large gains of the highest income groups. If we raise or eliminate the cap, we make the tax system less regressive and generate new income to enhance Social Security benefits.⁴⁵
5. **Enabling all workers to build up savings and retirement accounts** during their working lives **to supplement** the guaranteed foundation provided by Social Security. Promising models include President Clinton's proposal for USA Accounts and state-based approaches now under development, such as Washington Voluntary Accounts. Such accounts must be *in addition* to Social Security and not carved out of Social Security's guaranteed base.⁴⁶

V. CONCLUSION

For over 60 years Social Security has strengthened families, protected seniors, and guaranteed economic stability to families that suffered the death or disability of a wage earner. Whether the economy is up or down, by protecting the young and old, the lucky and unlucky, and the high earners and low earners, Social Security helps keep individual families, their communities, and our whole society prosperous.

Despite the rhetoric of crisis purveyed by supporters of privatization, Social Security has the resources to continue successfully. For the past 20 years, workers have been paying extra into the system in anticipation of the retirement of the large baby boom generation. Even with average life spans lengthening, total costs of the program will only increase by 2% of our national economy over the next several decades. Not only will Social Security continue to be there when today's young workers and their children are retired, it will provide them with higher benefits after inflation than their grandparents are getting now.

The threat to Social Security's future is entirely political, not demographic or financial.

As successful as Social Security is, modest reforms would make the program even better. If we cut through the cloud of misinformation to see the financial strength of Social Security, we can begin to make changes that would further enhance economic security for the most vulnerable recipients today.

Notes

⁰ The 2004 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds (2004 Trustees Report), p. 2.
<http://www.ssa.gov/>.

¹ Social Security Administration, "OASDI Beneficiaries by State and County, 2002: Washington," December 2002. http://www.ssa.gov/policy/docs/statcomps/oasdi_sc/2002/wa.html.

² Social Security Administration, 2004 Social Security Changes Fact Sheet, <http://www.ssa.gov/pressoffice/factsheets/colafacts2004-alt.htm>.

³ Social Security Administration, Basic Social Security Fact Sheet – 2003, <http://www.ssa.gov/pressoffice/factsheets/basicfact-alt.htm>.

⁴ Social Security's definition of disability is related to ability to work. To qualify for Social Security disability benefits, you must have a physical or mental impairment that is expected to keep you from doing any "substantial" work for at least a year, or have a condition that is expected to result in your death. To qualify for disability benefits it is only necessary to work for one and a half years. <http://www.ssa.gov/pubs/10024.pdf>.

⁵ SSA, Basic Fact Sheet.

⁶ Catherine Hill and Virginia Reno, "Children's Stake in Social Security," National Academy of Social Insurance, February 2003.

⁷ In 1983 Congress voted to gradually increase the retirement age for full benefits to age 66 in 2009, and age 67 in 2027. This increase began in 2003, when workers born between January 2, 1938, and January 1, 1939, will have to work until age 65 and 2 months to receive full benefits (which also affects people turning 62 in 2000 who opt for early retirement). The increase continues gradually, eventually reaching age 67 for those born in 1960 or later.

⁸ SSA, , 2004 Social Security Changes Fact Sheet, <http://www.ssa.gov/pressoffice/factsheets/colafacts2004-alt.htm>.

⁹ National Council of Women's Organizations, "Strengthening Social Security for Women," July 1999, p. 1.

¹⁰ Based on the Social Security Administration's website "Benefit Calculator," <http://www.ssa.gov/OACT/quickcalc/calculator.html>.

¹¹ Peter R. Orszag, Iris Lav, and Robert Greenstein, "Exacerbating Inequities in Pension Benefits: An Analysis of the Pension Provisions in the Tax Bill," Center on Budget and Policy Priorities, October 8, 1999, p. 3; SSA, *Income of the Population 55 or Older, 1996*, Table V.C.7. [www.ssa.gov].

¹² Carmen D. Solomen, "Major Decisions in the House and Senate Chambers on Social Security: 1935-1985," Congressional Research Service, Library of Congress, 1986.

¹³ 2004 Trustees Report, p. 81; Jack VanDerhei and Craig Copeland, "The Changing Face of Private Retirement Plans," EBRI Issue Brief Number 232, April 2001., p. 18.

¹⁴ U.S. Census, Poverty Status of People by Age, Race, and Hispanic Origin: 1959 to 2001, Table 3, <http://www.census.gov/income/histpov/hstpov3.lst>.

¹⁵ Maya Rockey Moore, "Social Security Reform and African Americans: Debunking the Myths," National Urban League, Policy Brief No. 2, August 2001, p. 3.

¹⁶ SSA, African Americans and Social Security, <http://www.ssa.gov/pressoffice/factsheets/africanamer.htm>.

¹⁷ 2004 Trustees Report, p. 4.

¹⁸ Social Security benefits are subject to income tax only if people have substantial other income. Individuals may owe tax if their other income plus half their Social Security benefits exceed \$25,000, and for couples if it exceeds \$32,000. See IRS Publications 554 and 915 for more information, www.irs.gov.

¹⁹ For the narrow definition of insolvent used by the Trustees, see 2004 Trustees' Report, p. 3.

²⁰ The Trustees' annual reports from previous years are also available on the Social Security Administration website, at www.ssa.gov.

²¹ One of the proposals frequently made to save money in the Social Security system is to peg benefit growth to inflation rather than average wages. The problem with this proposal is that it would not allow benefits to keep up with rising living standards. For example, many of today's older retirees started out their work lives in an era when laundry was done by hand and few non-urban families had indoor plumbing or electricity. No one would expect them to go without these conveniences today, yet benefits based on inflation rather than growth in productivity would not provide the income to keep up with such changes. For a more thorough discussion, see Christian Weller, "Shortchanging the Next Generation," Economic Policy Institute, September 2001, http://www.epinet.org/content.cfm/issuebriefs_ib162.

²² A troubling development for Social Security and other social policies is the growing inequality in incomes. During most of the 20th century, the American middle class grew and incomes became more equitably distributed, but since 1979 middle and lower income workers have seen relatively little income growth, while the highest income families have seen their incomes soar. See Jared Bernstein, Lawrence Mishel, and Chauna Brocht, *Pulling Apart: A State-by-State Analysis of Income Trends*, Economic Policy Institute and Center on Budget and Policy Priorities, September 2000.

²³ Congressional Budget Office, "A 125-Year Picture of the Federal Government's Share of the Economy, 1950-2075," July 3, 2002, [ftp://ftp.cbo.gov/35xx/doc3521/125RevisedJuly3.pdf](http://ftp.cbo.gov/35xx/doc3521/125RevisedJuly3.pdf); CBO, "An Analysis of the President's Budgetary Proposals for Fiscal Year 2005," March 2004, [ftp://ftp.cbo.gov/51xx/doc5151/03-08-PresidentsBudget.pdf](http://ftp.cbo.gov/51xx/doc5151/03-08-PresidentsBudget.pdf); and CBO, Historical Budget Series.

²⁴ For additional discussion of the trust fund, see Dean Baker, "Comments Presented to the President's Commission to Strengthen Social Security," August 2001, Center for Economic and Policy Research, http://www.cepr.net/Social_Security/baker_comments_to_committee.htm.

²⁵ Medicare has two parts, Hospital Insurance which is funded through payroll taxes like Social Security, and Supplementary Medical Insurance, or Part B, which covers physicians and outpatient services. The federal government pays 75% of the costs of Part B through general tax revenues, and beneficiaries pay premiums that cover the rest. A new prescription drug benefit is expected to go into effect in 2006.

²⁶ See Social Security and Medicare Boards of Trustees, "Status of the Social Security and Medicare Programs: A Summary of the 2004 Annual Reports."

²⁷ World Health Organization, *World Health Report 2003*, Statistical Annex, www.who.org; Gerard F. Anderson, Uwe E. Reinhardt, Peter S. Hussey, and Varduhi Petrosyan, "It's the Prices Stupid: Why the United States Is So Different From Other Countries," *Health Affairs*, vol 22, no 3, May/June 2003: 89-105, www.healthaffairs.org; Bureau of Labor Education, University of Maine, "The U.S. Health Care System: Best in the World, or Just the Most Expensive?" Summer, 2001, <http://dll.umaine.edu/ble/BRIEFS.html>.

²⁸ "GM Health Care Bill Tops \$60 billion," *The Detroit News*, March 11, 2004, <http://www.detroitnews.com/2004/autosinsider/0403/11/a01-88813.htm>; "A Heftier Dose to Swallow," *The Washington Post*, March 6, 2004, <http://www.washingtonpost.com/ac2/wp-dyn/A34899-2004Mar5?language=printer>.

²⁹ Washington State Office of Financial Management, "Adequacy of State Revenues," February 2002, <http://www.ofm.wa.gov/budget/manage/adequacy/ofm20020208.pdf>.

³⁰ Heather Boushay and Joseph Wright, "Health Insurance Coverage in the United States," Health Insurance Data Brief 2, April 2004, Center for Economic and Policy Research, http://www.cepr.net/health_insurance/hi_2.pdf. See also "Trends and Indicators in the Changing Health Care Marketplace," Kaiser Family Fund, 2002, <http://www.kff.org/insurance/loader.cfm?url=/commonspot/security/getfile.cfm&PageID=14967>.

³¹ Eliminating the cap has been estimated to generate an additional 1.53% of payroll. The Trustees in 2004 estimated a 75 year actuarial deficit of 1.89% of payroll. Working Conference on Women and Social Security, "Strengthening Social Security for Women," July 1999, Task Force on Women and Social Security of the National Council of Women's Organizations and Institute for Women's Policy Research, p. 4, 11; Dean Baker, "Comments Presented to the President's Commission to Strengthen Social Security," August 2001, Center for Economic and Policy Research, http://www.cepr.net/Social_Security/baker_comments_to_committee.htm.

³² Congressional Budget Office, "Effective Federal Tax Rates, 1997-2000," August, 2003, www.cbo.gov.

³³ Both of these organizations promote a number of ways to reduce government and increase corporate power, including by privatizing Social Security. See <http://www.cato.org>, and <http://www.heritage.org>.

³⁴ The Commission's alternatives were to divert 2% of wages into private accounts, divert 4%, and divert 2.5% from payroll taxes plus an additional 1% of wages. President's Commission to Strengthen Social Security, "Strengthening Social Security and Creating Personal Wealth for All Americans," December 21, 2001.

³⁵ Stephen C. Goss, Chief Actuary, Social Security Administration, to Daniel Patrick Moynihan and Richard D. Parsons, January 31, 2002, "Estimate of Financial Effects for Three Models Developed by the President's Commission to Strengthen Social Security"; Peter Diamond and Peter Orszag, "Reducing Benefits and Subsidizing Individual Accounts: An Analysis of the Plans of the President's Commission to Strengthen Social Security," June 2002, Center on Budget and Policy Priorities and the Century Foundation, <http://www.cbpp.org/6-18-02socsec.pdf>.

³⁶ Diamond and Orszag, "Reducing Benefits and Subsidizing Individual Accounts."

³⁷ Social Security Administration, "Fact Sheet, Women and Social Security," www.ssa.gov/pressoffice/womenfact.htm.

³⁸ SSA, "Fact Sheet, Social Security is Important to African Americans," www.ssa.gov/pressoffice/afamfact.htm.

³⁹ U.S. General Accounting Office, "Pension Plans: Characteristics of Persons in the Labor Force Without Pension Coverage," August, 2000, p. 4; Craig Copeland, "Retirement Plan Participation: Full-Time, Full-Year Workers Ages 18-64," *EBRI Notes*, Employee Benefit Research Institute, January 2001; Jack VanDerhei and Craig Copeland, "The Changing Face of Private Retirement Plans," EBRI Issue Brief Number 232, April 2001.

⁴⁰ U.S. Census Bureau, "Poverty in the United States, 1999," September, 2000, www.census.gov; Michael A. Anzick and David A. Weaver, "Reducing Poverty Among Elderly Women," Social Security Administration, January 2001, <http://www.ssa.gov/policy/docs/workingpapers/wp87.pdf>.

⁴¹ SSA, Primary Insurance Amount, <http://www.ssa.gov/OACT/COLA/piaformula.html>.

⁴² This reform would cost between 0.1% and 0.3% of payroll. Working Conference on Women and Social Security, "Strengthening Social Security for Women," July 1999, Task Force on Women and Social Security of the National Council of Women's Organizations and Institute for Women's Policy Research, p. 4, 11.

⁴³ Surviving spouses of couples that had received a couple's benefit of 1.5 times the primary wage earner's benefit would lose one third of their benefit when one spouse died. Survivors of couples in which each spouse had collected their own separate benefit would lose up to half the couple's combined benefits. This reform would cost about .46% of payroll, according to "Strengthening Social Security for Women".

⁴⁴ OWL, "Social Security Privatization: A False Promise for Women," 2002 Mother's Day Report, www.owl-national.org.

⁴⁵ Eliminating the cap would generate an addition 1.53% of payroll for Social Security. "Strengthening Social Security for Women".

⁴⁶ See EOI proposal at <http://www.eoionline.org/Policy-WVA.htm>, and Steve Idemoto, "Washington Voluntary Accounts: A Proposal for Universal Pension Access," Economic Opportunity Institute, October 2002, <http://www.eoionline.org/WVA/WVA-ProposalForUniversalPensionAccess2002.pdf>.