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BRIEFING PAPER

## Empty Promise: The Benefit to African American Men of Private Accounts Under President Bush's Social Security Plan

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In his effort to promote a plan for partially privatizing Social Security, President Bush has made a special effort to reach out to the African American community. The basis of this appeal is his contention that African Americans, and especially African American men, get a bad deal on Social Security because they have shorter life expectancies than whites. Since the Social Security retirement benefit is an annuity – an annual payment that lasts as long as a person lives – people who cannot expect to live long in retirement will not collect this benefit for very many years, and therefore will not get as good a return on the money paid into Social Security. By contrast, if they have paid their money into a private account instead, this account can be passed on to children or other heirs. For this reason, the President argues that his private accounts will be especially advantageous to African Americans.

There are many things wrong with this logic. First, the Social Security payback structure is very progressive. Since African Americans earn less on average than whites, they get a much higher percentage of their wage back in benefits for the years that they receive benefits. Several studies have found that the progressivity of the payback structure largely or completely offsets the impact of shorter life expectancies, to provide a return to black men that is approximately the same as the return to white men.<sup>2</sup> It is also important to remember that the retirement program is only one portion of the Social Security system. African Americans benefit disproportionately from the survivors and disability portions of the program, so the Social Security system as a whole gives substantially higher returns to African Americans than to whites.<sup>3</sup>

However, the biggest flaw in the President's argument is that most African American men would be in the exact same situation with his system of private accounts as they are now with Social Security. President Bush's plan would require workers to buy an annuity large enough to ensure that (when combined with their traditional Social Security benefit) they would have at least a poverty level income in their retirement. For most African American men, this requirement means that they will have to surrender their individual accounts, and will have nothing left to pass onto their children – just as is the case with the current Social Security system. In short, President Bush's system of private accounts will not offer most African American men the opportunity to pass on an inheritance, unless they have an independent source of wealth.

### **The Arithmetic of Disappearing Private Accounts**

The key issue in determining the extent to which workers will be able to pass on the money in their private accounts is how close the worker's traditional benefit is to the poverty line. While the private account can raise the size of this benefit to some extent,

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<sup>2</sup> See "How Progressive Is Social Security When Old Age and Disability Insurance Are Treated As a Whole?" 2004. Steurele, E. and A. Carosso, and L. Cohen, the Urban Institute [<http://www.urban.org/url.cfm?ID=311017>].

<sup>3</sup> President Bush has said that he wants to leave the disability and survivors' portion of the program unchanged. Regardless of his intentions, it is not clear that if these programs existed as stand-alone programs they would enjoy the same political support as they do presently. Also, there are efficiencies associated with having a single system that would be lost if part, or all, of the retirement program was separated from the other two programs.

most of the money accumulated in the private account will simply offset cuts in the traditional Social Security benefit. This means that if the defined benefit is not at or above the poverty line, then under President Bush’s plan, the private account will have to be used to buy an annuity to make up the difference.

If the basic Social Security benefit is price indexed, instead of wage indexed, in the years after 2009, as envisioned in Plan 2 designed by President Bush’s Social Security Commission (the plan that President Bush indicated would likely form the basis for whatever proposal he eventually puts forward), then the median benefit for African American men is likely to be well below the poverty line. While wage indexing would raise the real value of the Social Security benefit for new retirees by the 1.1 percent projected rate of real wage growth, price indexing effectively freezes the benefit at the 2009 level.

Table 1 shows the projected benefit level for the median African American male, who was born in 1984 and turns age 25 in 2009, the year President Bush’s program is first supposed to go into effect. The first column shows the traditional Social Security benefit for African American men. The projection for 2009 assumes that the median benefit rises in step with the 1.1 percent average real wage growth projected by the Social Security trustees. (This assumes that wages for African American men grow at the same rate as the average wage in the economy.) Plan 2 indexes benefits after 2009 to prices, so benefits would not rise in real terms in subsequent years.

**Table 1**

**Projected Benefit Levels for Median African American Male – Born 1984  
(2004 dollars)**

	<b>Traditional SS Benefit</b>	<b>Account Annuity</b>	<b>Account Annuity After Clawback</b>	<b>Total SS Income</b>	<b>Poverty</b>	<b>Excess Income</b>
<b>Benefit 2000</b>	\$8,893				\$9,060	
<b>Benefit after 2009</b> (with retirement at age 62)	\$8,635	\$4,907	\$393	\$9,028	\$9,060	-\$32
<b>Benefit at age 65</b>	\$10,691	\$5,937	\$567	\$11,258	\$9,060	\$2,198
<b>Benefit at age 67</b>	\$12,336	\$7,244	\$1,074	\$13,410	\$9,060	\$4,350

Source: Author’s calculations, see appendix.

Column 2 shows the annuity that would be generated from the median worker's private account. This assumes a wage history consistent with the median African American's Social Security benefit, and the worker remaining in the labor force until the year they start collecting benefits. Column 3 shows the annuity that would be available to the worker, after subtracting the amount from the traditional Social Security benefit that is necessary to repay the funds that went into the private account. Column 4 shows the sum of the traditional Social Security benefit and the annuity net of the clawback. Column 5 shows the poverty level for a single person over age 65. Column 6 shows the excess benefit: the amount by which the combined benefit exceeds the poverty line.

The worker is only able to pass on a portion of his or her account to an heir if the combined benefit exceeds the poverty level. If the combined benefit does not exceed the poverty level, then the worker will be forced to annuitize their entire accumulation, leaving nothing to pass on, just as is the case with the current Social Security program.

As can be seen, in the case where a worker first starts collecting benefits at age 62, the combined benefit will fall \$32 below the poverty line.<sup>4</sup> This means that the median African American male will not be able to pass along any of his private account to his heirs, if he starts collecting benefits at age 62, even after President Bush's plan has been in place for 40 years. Under President Bush's plan, the government will force him to annuitize his lifelong savings, just as is the case with the current Social Security system.

It is important to realize that the situation of the median worker is better than that of the bottom half of the workforce. In other words, while the median African-American worker will be close to crossing the threshold where he would have something to pass onto heirs, half of all African American men are projected to be in worse shape.

In this respect, it is also important to note the importance of the age of retirement. The assumption that the median worker will have nothing to pass onto his heirs depends on their retiring at age 62. If they can wait until age 65 or age 67, then they would have an income above the poverty line and therefore be able to pass some of their account onto their heirs. However, most workers currently do start collecting Social Security benefits at age 62. While it is possible that this age will increase in the future (this is one of the goals of the increase in the normal retirement age for Social Security), it will almost certainly be the case that a large portion of the workforce will still opt to start collecting benefits at age 62. This is likely to be especially true of those who are in poor health and most likely to die at an early age.

Table 2 shows the potential inheritance, based on the accumulations in their private accounts, for the median earning African American worker born in 1984. The

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<sup>4</sup> It is worth noting that plan 2 does propose some special provisions for low earning workers which raises their benefits. It is possible that these provisions could raise the benefit above the poverty level for many African American men, thereby ensuring that they have something to pass on to their heirs, but this is not certain. The provisions have differing impacts depending on the timing of a worker's earnings. Under these provisions, two workers with the same average earnings will receive different benefits depending on the number of years that they contributed to the Social Security system.

table assumes alternatively that this worker starts collecting benefits at age 62, age 65 and age 67. While the worker who retires at age 62 will not be able to pass anything on to his heirs, the workers who retire at age 65 and age 67 will in principle be able to pass on modest inheritances.

**Table 2**

**Potential Bequest – Median African American Male, Born 1984**

	<b>Account Accumulation</b>	<b>Mandatory Annuitization</b>	<b>Potential Bequest</b>
<b>Retire at Age 62</b>	\$87,508	\$87,508	\$0
<b>Retire at Age 65</b>	\$102,177	\$67,736	\$34,441
<b>Retire at Age 67</b>	\$112,967	\$47,506	\$65,461

Source: Author's calculations, see appendix.

It is important to realize how limited the potential bequests would be even for the African American workers who managed to stay in the labor force to an age where they could legally make a bequest under President Bush's plan. The potential bequest sums are the amount that a worker could pass along assuming that they could survive in their retirement on a poverty-level Social Security benefit. This would mean either that they were prepared to live out their life at the edge of poverty, or that they have accumulated a substantial source of wealth from another source. In the latter case, it is not the private account that is making the bequest possible, but rather the fact that the worker was able accumulate wealth outside of the Social Security system.

The second factor to consider is that these bequests will not be very large in the context of the economy at the middle of the 21<sup>st</sup> century. Even the \$65,500 potential bequest by a worker who retired at age 65 would only be equal to about 14 months pay for a medium income worker at that time. Alternatively, if price indexation is put into effect as envisioned by Plan 2, this bequest would be less than nine years of the benefit cut that would be experienced by a medium income worker. In other words, even if an older worker were willing to make extreme sacrifices for his heirs (by spending his retirement at the edge of the poverty line), the bequest that he would control under the Bush plan would still be very limited relative to the wealth of the mid-century economy.

**Conclusion**

President Bush has aggressively promoted his Social Security plan among African Americans, with the promise that it will allow them to pass on their private accounts to their heirs. He has argued that this will be preferable to Social Security, because African Americans, and especially African American men, have shorter life-spans than whites, and therefore do not collect Social Security benefits for as many years.

However, because President Bush's plan mandates that workers annuitize enough of their accounts to generate an income that is at least large enough to put them above the poverty level, most African American men will not accumulate enough money to pass anything down to their heirs. In this respect, for the typical African American man, President Bush's proposed system will be exactly the same as the current Social Security system; it will not leave them with anything to pass onto their heirs.

The obvious way to ensure that African Americans get a better deal from Social Security is to address the factors that lead them to have shorter lives – lower wages, poor living conditions, and inadequate health care. While these problems cannot be addressed overnight, it is certainly reasonable to believe that substantial progress can be made in the 45- year time horizon over which President Bush's Social Security plan would be phased in. It would be preferable to attack the causes of inequality in life expectancies, rather than structuring our retirement system around them.

## Appendix

The projection for both future Social Security benefits and the future wage income is derived from the median Social Security benefit for single black men in 2000 of \$8,057. This was converted to 2004 dollars assuming 2.5 percent inflation for each year from 2000 to 2004. (*Income of the Population 55 or Older, 2000*, Table 5.A3 [[http://www.ssa.gov/policy/docs/statcomps/income\\_pop55/2000/sect5a.html#t5\\_A3](http://www.ssa.gov/policy/docs/statcomps/income_pop55/2000/sect5a.html#t5_A3)]). The calculation assumes that wage income and benefits rise at the 1.1 percent of annual wage growth until 2009. After that point, benefits are assumed to be price indexed, so the real value of the benefit does not rise, even as real wages continue to grow at a 1.1 percent annual rate. The benefit is assumed to fall by 12.5 percent as a result of the increase in the normal retirement age from 65 to 67, which is completed by age 62.<sup>5</sup> (It is assumed that the worker retires at age 62, which is approximately 6 months younger than the median age when all workers first start collecting benefits. While this age may increase due to the rise in the retirement age and improving health care, it is likely to remain close to age 62 for those in poor health and with low life expectancies.)

Workers' wage history is calculated to produce an annual Social Security benefit of \$8,637 (a benefit of \$12,339 at the normal retirement age of 67 in years after 2022). This corresponds to an average indexed annual wage of \$24,345 in 2009 (in 2004 dollars), with the wage rising each year in step with the 1.1 percent projected rate of wage growth. This projection implies that workers have no increase in their wage over their working lifetime – that they start working and contributing to their accounts at age 25, at the same wage that they work at throughout their career.

This pattern will result in some overstatement of the amount accumulated in the account, since workers will typically earn much lower pay in their twenties and early thirties, than in their late thirties and forties. Therefore assuming equal annual earnings over a 35-year career (relative to the economy-wide average) will imply more money accumulating in the private accounts in the worker's career than is likely to be the case.

It is assumed that workers always place the maximum of four percent of their wages in the accounts. This money is assumed to earn a gross return of four percent, which yields a net return of 3.7 percent after deducting 0.3 percent for administrative fees.

The annuities are calculated assuming a 5 percent annuity fee (covering adverse selection and administration fees), a 3.0 percent real interest rates, and based on a 20.85 year life expectancy at age 65 (Table V1.A4). The annuity calculated for those retiring at age 62 is based on a life expectancy of 23.0 years. This is based on the HCFA Medicaid Life Expectancy Tables [<http://www.aboutjoints.com/patientinfo/topics/generalinformation/femalelifeexpect.htm>] and [<http://www.aboutjoints.com/patientinfo/topics/generalinformation/malelifeexpect.htm>], which show that life expectancy is currently 2.17 years longer at age 62 than age 65. The 23.0 year life expectancy assumption for age 62 in 2046 assumes that this gap does not

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<sup>5</sup> Social Security Trustees Report, 2004, Table V.C3.

change. Similarly, the annuity calculations for age 67 assume a life expectancy of 19.48 years since the life expectancy tables show a drop in life expectancy for men at age 67 of 1.26 years compared to age 65, and a drop for women of 1.48 years.

The 2004 poverty level for a single individual over age 65 is \$9060 (U.S. Census Bureau, Poverty Thresholds [<http://www.census.gov/hhes/poverty/threshld/thresh04.html>]).