

The **Perils** of Privatization

**Social Security Privatization
Cuts Lifetime Benefits;
Makes Senior Citizens Vulnerable to Poverty**

**The Impact on
African Americans**

August 7, 2008

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Social Security Privatization

Cuts lifetime benefits for African Americans by as much as \$240,264

Makes 888,000 African-American senior citizens vulnerable to poverty.

Institute for America's Future

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Social Security is back in the news. In a town-hall event on July 7, 2008, a young woman asked Arizona Senator John McCain if she was likely to receive Social Security benefits someday. In his reply, McCain lamented Social Security's design and structure and, as he had elsewhere, indicated that he would radically change this successful program.¹ He said, "Americans have got to understand that we are paying present-day retirees with the taxes paid by young workers in America today, and that's a disgrace, it's an absolute disgrace and it's got to be fixed."²

We've been here before. Three years ago, President Bush declared that Social Security faced a financial crisis, and his solution was privatization — taking payroll taxes we all pay into the system and investing a portion of those funds in private stock market accounts. Now John McCain is bringing the idea back. In March 2008, McCain told the Wall Street Journal, "As part of Social Security reform, I believe that private savings accounts are a part of it — along the lines that President Bush proposed."³ The idea became more concrete in July 2008, when McCain named economist Martin Feldstein, the "chief intellectual force behind privatization," as a surrogate on his campaign.⁴ These moves revive an idea that the American people rejected three years ago.

This report updates research published by the Institute for America's Future at that time. It estimates the reduction in Social Security benefits that a typical African-American resident can expect and the number of seniors exposed to poverty if Social Security were privatized. The main findings are that:

For future generations, Social Security privatization would:

- Cuts life-time benefits for African Americans by \$240,264
- Makes 888,000 African-American senior citizens vulnerable to poverty.

Social Security Works

Social Security is not a "disgrace." It is a successful social program and a profound intergenerational promise. Every generation pays into Social Security during its turn, and withdraws from Social Security when its time comes. Social Security has been successfully operating that way for over 70 years.

Social Security works. It lifts 1.3 million children and nearly 13 million senior citizens out of poverty.⁵ Social Security provides 73 percent of the typical retiree's income, compared to 17 percent from pensions and 10 percent from savings and other sources.⁶

Before Social Security, nearly half of American seniors lived in poverty. Today, fewer than 9 percent of seniors spend their “golden years” in poverty.⁷ Social Security is especially important now, with private sector pensions disappearing and savings scarce. According to the estimates by the Economic Policy Institute, without Social Security, more than 35 percent of Americans aged 65 and older would be living in poverty.

Social Security and African Americans

Currently, over 5 million African Americans receive Social Security benefits; half of whom receive retirement benefits.⁸ Studies have shown that the progressive benefit structure and survivors and disability benefits disproportionately benefit African Americans because they are more likely than other workers to become disabled or die before retiring.⁹ In 2005, Social Security provided benefits to more than 80 percent of African Americans over the age of 65. The American Association of Retired Persons notes that in 2005 the poverty rate for African Americans age 65 and older was more than twice that of all older people, at 23 percent—without Social Security benefits, the percentage of those African Americans would increase to 60 percent.¹⁰

Real Security. Created Crisis.

Some politicians and conservative privatization advocates have created a myth that Social Security is in crisis. They issue dire warnings and predict imminent bankruptcy. McCain told the young woman in the July town hall event that it was “unlikely” she would receive her benefits. President Bush tells a story of a poll of young people who “think it's more likely they're going to see a UFO than get a Social Security check.”¹¹ The White House web site elaborates: “If we do not act to fix Social Security now, the only solutions will be dramatically higher taxes, massive new borrowing or sudden and severe cuts in Social Security benefits or other government programs.”¹²

The proclamations work. One poll says that 73 percent of Americans believe Social Security has “major problems” or is in “crisis.”¹³

The reality is far different. Social Security currently has a surplus of \$2 trillion. The surplus is projected to increase to over \$4 trillion by 2016, more than four times the amount needed to pay benefits in that year.¹⁴ According to cautious estimates by the Congressional Budget Office, the Social Security trust fund would not be depleted until 2046.¹⁵

Privatization: Risks and Realities

Privatization means diverting deductions from the Social Security trust fund into private accounts run by private investment companies. Conservatives have touted privatization for years as a way to increase returns on investment. Privatization, however, has a variety of problems.

First, privatization would transfer huge administrative fees to Wall Street. Managing large numbers of small accounts is inherently inefficient. Administrative costs for private systems in Mexico, Chile and Argentina are between 1.8 to 2.4 percent of the program total; in England, administrative costs are 3.2 percent. In contrast, administrative costs of Social Security run less than one percent.¹⁶

Second, diverting funds would cause the trust fund's surplus to run out much sooner, leading to benefit reductions and retirement insecurity — the opposite of Social Security's intergenerational promise. The Center on Budget and Policy Priorities estimates that President's Bush's plan would have created \$17.7 trillion in additional debt by 2050.¹⁷

Third, and most importantly, privatization replaces the guaranteed floor of economic security with the uncertainty of the stock market. In 2007, Social Security guaranteed economic security to more than 49 million grandparents, parents and children worldwide.¹⁸ Individuals are free, of course, to invest their personal savings in the stock market — but Social Security guarantees a floor beneath which their fortunes will not fall. Furthermore, the risk of the stock market could provide great risks for African Americans. The Center for Budget and Policy Priorities notes, “the risks of replacing part of Social Security with private accounts would be more acute for African Americans than for whites, while the potential rewards likely would be smaller.”¹⁹

Research Findings

In the United States, 48.5 million count on their earned Social Security benefit every month—including 5 million African Americans.²⁰ In addition to the benefits that Social Security provides to African-American families, it also provides a stable level of individual income that fuels the United States economy. Thousands of businesses, and the state government, also depend on the Social Security guarantee. Fully \$580.5 billion in individual income flows into the United States's economy from Social Security each year — roughly \$48.4 billion every month.²¹

Privatization could cast many African-American seniors below the poverty line. According to the U.S. Census Bureau, over 9.4 million African Americans in the United States lived in poverty in 2006.²² In 2005, almost 80 percent of African American seniors relied on Social Security checks for at least half of their total income. 44 percent of these individuals depend on these benefits for all of their income.²³ In 2006, 33 percent of African American elderly couples and 54 percent of unmarried elderly relied on Social Security for 90 percent or more of their income.²⁴ Today, the average Social Security check for individual retirees in the United States is \$1,088 per month.²⁵ But \$867 per month is needed just to stay above the federal poverty line. These individuals are close to the edge, and vulnerable to swings in the cost of food, housing or energy.

The Center on Budget and Policy Priorities calculated in 2005 that if a Bush-style privatization plan were enacted, children born around the time the plan started would have their annual guaranteed benefits cut by 50 percent when they retire.²⁶ If that were to happen to current-day African-American senior citizens in the United States, those with incomes up to 191% of the current poverty line would no longer have a guarantee that they would avoid poverty.²⁷ Social Security would have failed in its promise of security. 888,000 African-American senior citizens in the United States would be left behind.²⁸

Second, benefits would be reduced even among people not plunged into poverty. Under a Bush-like privatization plan, an African American born today in the United States who retires at the current full retirement age of 67, would see a lifetime benefit cut of \$240,264 in today's dollars.²⁹ This is the benefit cut an African American would suffer even *after* accounting for earning an average 4.35 percent return on their private account investment.³⁰

The Solution

Social Security is not going bankrupt. But we do need to pay attention to the impact the retirement of the baby-boom generation is having on the program. The solution is to strengthen the existing structures, not to reinvent them or privatize them. Currently, the Social Security payroll tax currently applies only to the first \$102,000 a worker makes — any earnings above that are tax-free. One simple solution is to apply the tax to some or all earnings above \$102,000. Lifting that cap is a fair and minor adjustment that could prevent any shortfall after 2046.³¹

— Dean Baker, Co-Director of the Center for Economic and Policy Research, contributed technical assistance to this report.

ENDNOTES

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- ² Charles Babington. "Road Still Bumpy for McCain's Retooled Bandwagon." *Associated Press*. 12 July 2008. <http://ap.google.com/article/ALeqM5gYfclM-O18cCsF6qDZZJXZTkH9wD91SO1000>. John McCain on Social Security. <http://www.youtube.com/watch?v=ugN8Rn5baqM>.
- ³ Bob Davis. "McCain's Economy Platform: Big Tax Cuts, With Caveats." *Wall Street Journal*. 3 March 2008. http://online.wsj.com/public/article_print/SB120451614688707083.html.
- ⁴ Carolyn Lochhead. "Friedman's 'heresy' Hit Mainstream: Private Social Security Accounts were His Idea." *San Francisco Chronicle*. 5 June 2005. <http://www.sfgate.com/cgi-bin/article.cgi?f=/c/a/2005/06/05/ING9QD1E5Q1.DTL>. Feldstein is widely acknowledged as the "chief intellectual force behind privatization" of Social Security. He wrote *The Case for Privatization* (<http://www.foreignaffairs.org/19970701faessay3782/martin-feldstein/the-case-for-privatization.html>) and *Privatizing Social Security: The Ten Trillion Dollar Opportunity* (<http://www.cato.org/pubs/ssps/ssp7.html>). Feldstein is also a surrogate of Senator John McCain. See: Senator John McCain. "Economists' Statement on John McCain's Jobs for America Economic Plan." 7 July 2008. *JohnMcCain.com*. <http://www.johnmccain.com/Informing/News/PressReleases/Read.aspx?guid=c90681b9-5dfe-4de4-8057-ceedb30c228d>. See also: Senator John McCain. "ICYMI: McCain Campaign Conference Call on John McCain's Jobs for America Economic Plan." *JohnMcCain.com*. 28 July 2008. <http://www.johnmccain.com/Informing/News/NewsReleases/Read.aspx?guid=37ce003f-9a85-4a45-ab1b-e5433a4c1693>.
- ⁵ Joni Lavery and Virginia P. Reno. *Children's Stake in Social Security*. Social Security Brief No. 27. *National Academy of Social Insurance*. February 2008. http://www.nasi.org/publications2763/publications_show.htm?doc_id=670348&name=Social%20Security. Arloc Sherman and Isaac Shapiro. *Social Security Lifts 13 Million Seniors Above the Poverty Line: A State-By-State Analysis*. Center on Budget and Policy Priorities. 24 February 2005. <http://www.cbpp.org/2-24-05socsec.pdf>.
- ⁶ Economic Policy Institute. *EPI Issue Guide: Retirement Security*. September 2006. http://www.epi.org/Issueguides/retire/retirement_security_issue_guide-epi.pdf.
- ⁷ Social Security Administration. www.ssa.gov.
- ⁸ United States Social Security Administration. *Annual Statistical Supplement, 2007; Old-Age, Survivors, and Disability Insurance; Table 5.J5.1 "Number, by state or other area, race, and sex, December 2006*. Office of Policy. <http://ssa.gov/policy/docs/statcomps/supplement/2007/5j.html#table5.j5.1>. William Spriggs and Jason Furman. *African Americans and Social Security: The Implications of Reform Proposals*. Center for Budget and Policy Priorities. 19 January 2006. <http://www.cbpp.org/1-18-06socsec.pdf>. In 2006, the Center for Budget and Policy Priorities estimated that "half of the 4.8 million African Americans [in 2006] who receive Social Security benefits today are retired workers. We continued to use their estimate in calculating that half of the more than 5 million African Americans are receiving retirement benefits.
- ⁹ William Spriggs and Jason Furman. *African Americans and Social Security: The Implications of Reform Proposals*. Center for Budget and Policy Priorities. 19 January 2006. <http://www.cbpp.org/1-18-06socsec.pdf>. Ke Bin Wu. *African Americans Age 65 and Older: Their Sources of Retirement Income in 2005*. American Association of Retired Persons Public Policy Institute. September 2007. http://assets.aarp.org/rgcenter/econ/fs137_aaincome.pdf.
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- ¹⁶ For analysis of Latin American Social Security privatization administrative fees; see: Barbara E. Kritzer. *Social Security Privatization in Latin America*. Social Security Bulletin. Vol.63. No.2. 2000. <http://ssa.gov/policy/docs/ssb/v63n2/v63n2p17.pdf>. For analysis of United Kingdom Social Security privatization administrative fees; see: John Turner. *Administrative Costs for Social Security Private Accounts*. AARP Public Policy

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¹⁸ National Committee to Preserve Social Security and Medicare. "Social Security Primer: History of the Social Security Program." February 2008. http://www.ncpssm.org/ss_primer/.

¹⁹ William Spriggs and Jason Furman. *African Americans and Social Security: The Implications of Reform Proposals*. Center for Budget and Policy Priorities. 19 January 2006. <http://www.cbpp.org/1-18-06socsec.pdf>.

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²⁹ Social Security Administration, "2005 OASDI Trustees Report," March 23, 2005. According to the 2005 Social Security Trustees Report, the average life expectancy for a person age 65 in the year 2080 is 22.4 additional years. Because the retirement age will reach 67 by 2027, the Institute for America's Future subtracted two years from the average life expectancy for and assumed retirement age of 67 in 2080. Therefore, all lifetime benefit calculations are based on a 20.4 years of life after age 67. See: Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds. *The 2005 OASDI Trustees Report*. 23 March 2005.

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(http://www.cepr.net/calculators/calc_benefits.html). The Institute for America's Future aggregated the monthly totals provided by the Center for Economic and Policy Research to derive lifetime totals. Total benefit cuts were adjusted to 2008 dollars.

³⁰ The stock return consistent with Congressional Budget Office (CBO) projections and a steady price-to-earnings ratio is 4.35 percent. Following CBO, this analysis assumes a portfolio consisting of 50 percent stocks, 30 percent private bonds and 20 percent Treasury bonds. The total real return from such a portfolio would be 3.97 percent before fees.

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