

# **Social Security: *Problem or Crisis?* *Reform or Restructure?***

**Prepared for Central New York Alliance of Retired Americans  
December 10, 2004**

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# **Main Points**

**Social Security works**

**Protections families can depend on**

**A real financing problem exists**

**Should be addressed**

**No magic bullets**

**Crisis rhetoric used to create misunderstandings**

**Privatization creates much larger financing problems**

**Privatization would place many at risk**

**Solutions exist that do not undermine SS**

**Important values at stake**

# **Social Security reform requires knowledge of**

**origins of Social Security**

**value of today's Social Security**

**current financing problems**

**implications of reforming vs. radical restructuring**

**values at stake**

# Join the march... to OLD AGE SECURITY



*Return*  
YOUR APPLICATION FOR A  
SOCIAL SECURITY  
RENTAL NUMBER  
*through the post office*  
NOT LATER THAN  
DEC. 5-1936

**WHO IS ELIGIBLE**... EVERYBODY WORKS FOR THE SECURITY OF A GOOD LIFE. ONLY A FEW EXCEPTIONS, SUCH AS NON-RESIDENTS, BORN IN FOREIGN COUNTRIES, AND NON-RESIDENT WORKERS, ARE EXCLUDED. THE SOCIAL SECURITY ACCOUNTS ARE NOW BEING ESTABLISHED THROUGHOUT THE COUNTRY. IF YOU ARE NOT AN OLD PERSON YOURSELF, HELP US GET THE MESSAGE OUT.

**HOW TO RETURN APPLICATION**

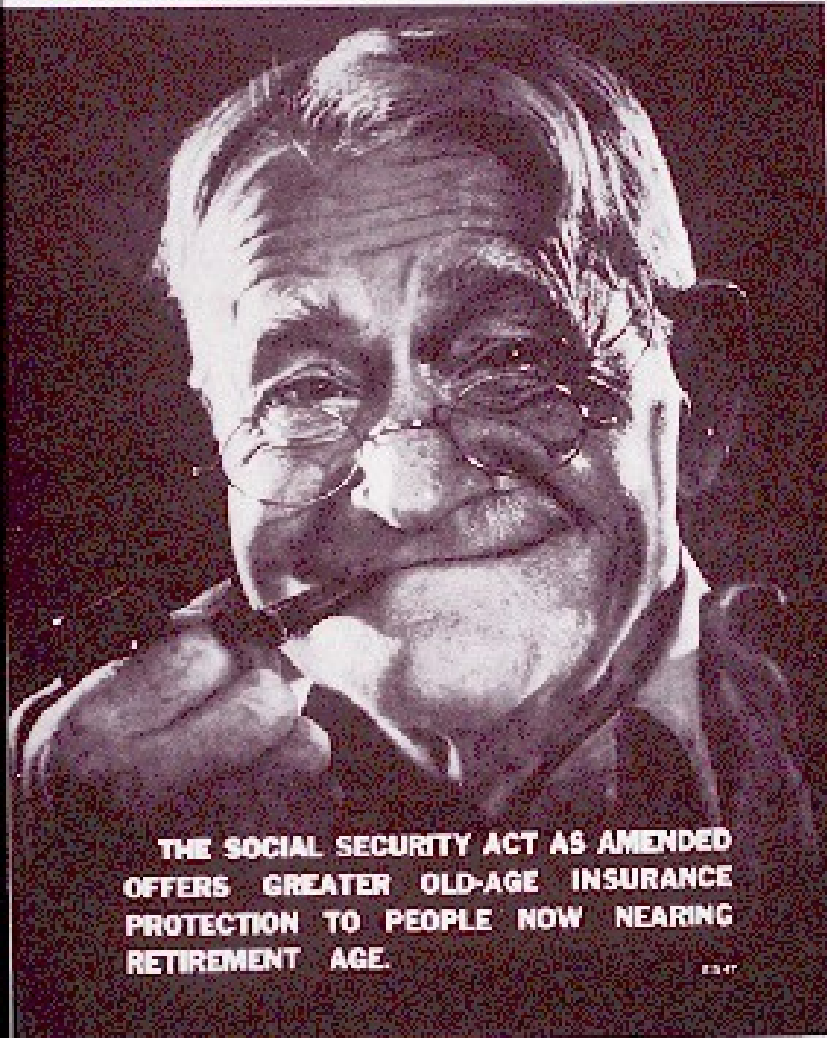
- 1. FILL IT OUT AND RETURN IT TO THE SOCIAL SECURITY BOARD, WASHINGTON, D. C.
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*- Social Security Board*

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## MORE SECURITY FOR THE AMERICAN FAMILY



**THE SOCIAL SECURITY ACT AS AMENDED OFFERS GREATER OLD-AGE INSURANCE PROTECTION TO PEOPLE NOW NEARING RETIREMENT AGE.**

SS-17

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# **BACKGROUND:** ***WHAT IS SOCIAL INSURANCE?***

- **DEFINITION OF TERMS**
- **EMERGENCE OF SOCIAL INS**
- **DEVELOPMENT IN THE U.S.**
  - **SETTING THE STAGE: 1900 TO MID 1930S**
  - **INCREMENTAL EXPANSION: 1939 -1975**
  - **FINANCING DOMINATES THE AGENDA:  
MID 1970S TO TODAY**
  - **A NEW DEBATE**

# EVOLUTION OF SOCIAL INSURANCE

## ■ ECONOMIC GROWTH

- CAN AFFORD DEPENDENCY
- WORK/LEISURE ALLOCATIONS

## ■ INCREASED NEED FOR PUBLIC SUPPORT

- WAGE DEPENDENT
- DEMOGRAPHIC CHANGES
- NEED FOR ORDERLY NEW RISKS EMERGE
- ON THE JOB INJURY
- UNEMPLOYMENT
- OLD AGE

# The door to the poor house



# **EARLY DEVELOPMENTS: 1900 TO MID-1930S**

- **SOCIAL INSURANCE & PUBLIC PENSIONS**
- **WORKER COMPENSATION**
- **BARRIERS TO SOCIAL INSURANCE**
  - **FEDERALISM/STATE DOMINATION IN SOCIAL WELFARE**
  - **STATE RIGHTS CONCERNS**
  - **INDIVIDUALISM**
  - **VOLUNTARY TRADITION**
  - **LACK OF SOCIAL DEMOCRATIC TRADITION**
  - **NO TRADITION OF A PATERNALISTIC ARISTOCRACY**
- **THE SOCIAL SECURITY ACT OF 1935**



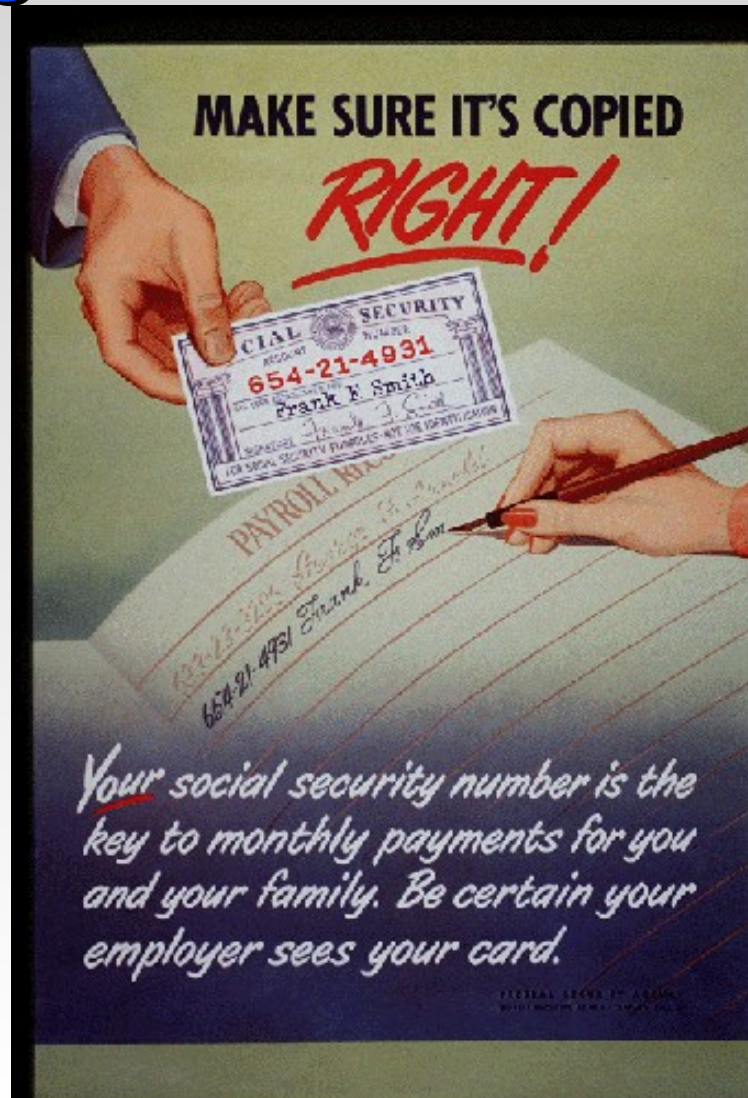
# Frances Perkins & FDR Signing the 1935 Social Security Act



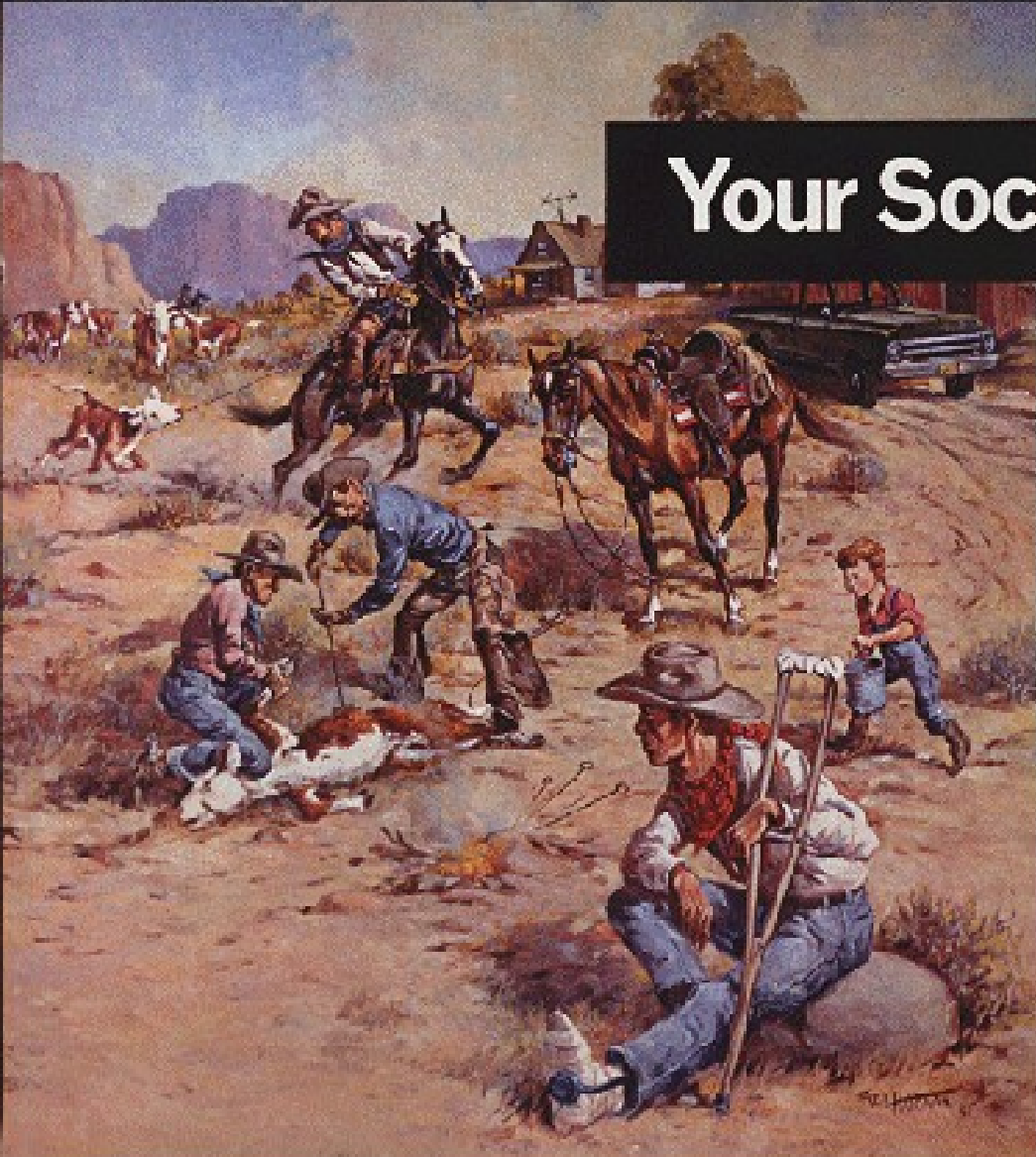
# Incremental Expansion 1939 to Mid- 1970s

- 1939, 1950, 1956, 1965, 1972
- Programs & Benefits added
- Benefit amounts increased
- Strong favorable Consensus

Downloaded from: Social Security Administration  
History Website <http://www.ssa.gov/history/history.html>



# Disability Insurance added in 1956




## Your Social Security

### DISABLED?

if your disability  
is expected to last  
a year or more-

*ask now about  
disability insurance  
benefits*



U.S. DEPARTMENT OF  
HEALTH, EDUCATION AND WELFARE  
SOCIAL SECURITY ADMINISTRATION

JUNE 1948 881-473

Downloaded from: Social Security Administration History Website

<http://www.ssa.gov/history/history.html>

# LBJ signs Medicare Law - 1965



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<http://www.ssa.gov/history/history.html>

# Marketing Medicare in 1965



**Your Social Security**

**MEDICARE** helps older Americans pay hospital and medical expenses

**NEARING 65?**

*Sign up for MEDICARE 2 or 3 months before your birthday*

  
U.S. DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE  
SOCIAL SECURITY ADMINISTRATION  
DHEW 1248 051-114

# Financing Issues Dominate the Agenda 1975+

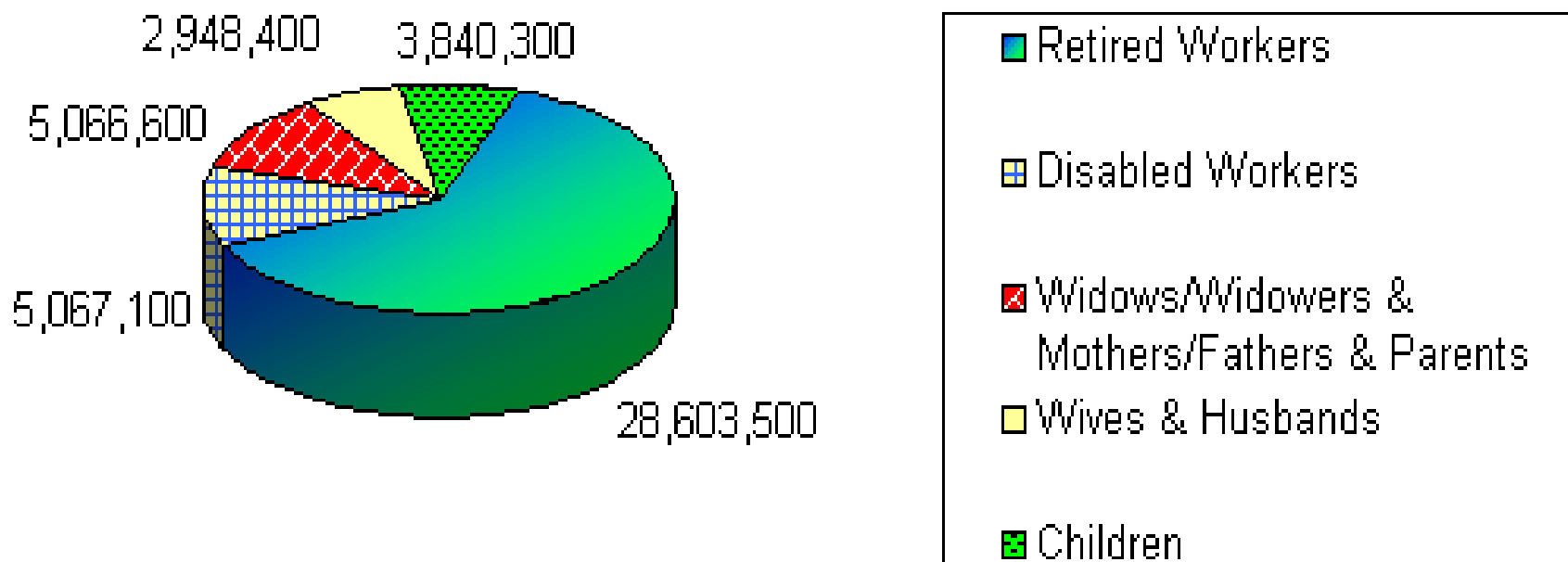
- **1977 legislation**
- **1983 legislation**
- **Emergence of Generational Equity Challenge**
- **Aging of Baby Boom**
- **Federal Deficit**
- **A Changed Debate: Legitimization of radical change**
  - **means testing**
  - **privatization**
  - **the 2000 presidential election**
  - **President's Commission to Strengthen Social Security**
  - **President's domestic agenda**

**To understand the future of  
Social Security, we must first  
clarify what's at stake**



# 47 Million Beneficiaries in 2004

**Number of Social Security Beneficiaries  
By Type of Benefit, February 2004**





# The Four Pillars of Retirement Security



**Social Security**



**Pensions & Savings**

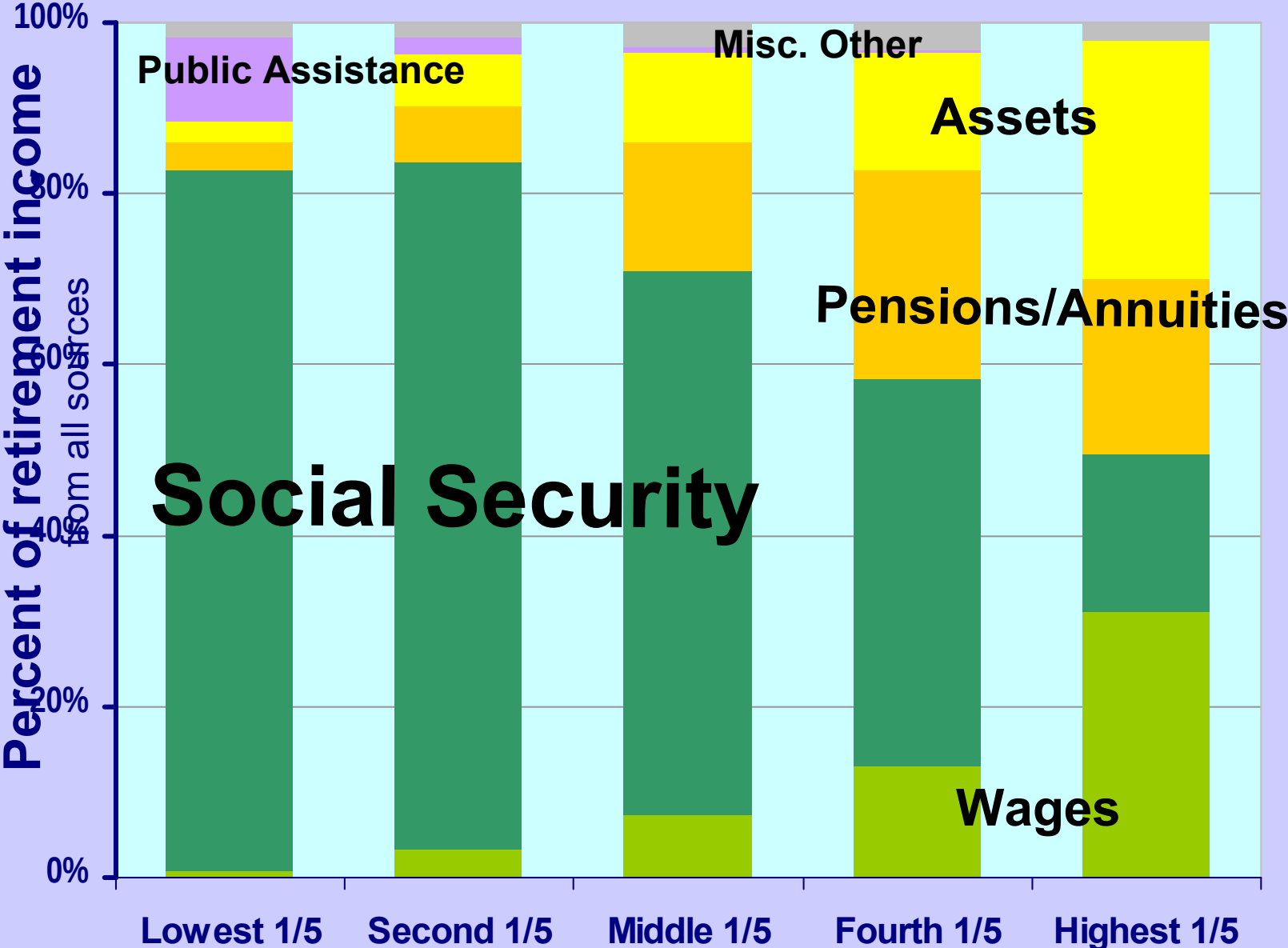


**Earnings**



**Health Insurance**

# Social Security: MAIN retirement income for 4/5 of economic brackets



Source: Social Security Administration, *Incomes of Population 55 & Older, 2000*

# Importance of selected sources of income to elderly (65+) households by quintiles, 2000

| All<br>Aged<br>Units | QUINTILES                         |                              |                               |                               |                              |
|----------------------|-----------------------------------|------------------------------|-------------------------------|-------------------------------|------------------------------|
|                      | Units<br>Under<br>\$9,295<br>(Q1) | \$9,296-<br>\$14,980<br>(Q2) | \$14,981-<br>\$23,631<br>(Q3) | \$23,632-<br>\$39,719<br>(Q4) | \$39,720<br>and over<br>(Q5) |

## Percent of Total Income From:

|                         |             |             |             |             |             |             |
|-------------------------|-------------|-------------|-------------|-------------|-------------|-------------|
| <b>Social Security</b>  | <b>38.4</b> | <b>82.3</b> | <b>81.6</b> | <b>64.1</b> | <b>46.0</b> | <b>19.4</b> |
| Government pension      | 8.2         | 0.7         | 2.4         | 6.2         | 10.2        | 9.4         |
| Private pension/annuity | 9.2         | 1.7         | 4.3         | 9.5         | 13.0        | 9.1         |
| Income from assets      | 17.5        | 3.3         | 5.1         | 9.4         | 12.8        | 24.2        |
| Earnings                | 23.1        | 1.3         | 2.6         | 6.7         | 14.2        | 35.2        |
| Public Cash Assistance  | 0.7         | 8.4         | 1.7         | 0.9         | 0.2         | 0.1         |

SOURCE: Income of the Population 85 or Older, 2000, Social Security Administration  
[http://www.ssa.gov/policy/docs/statcomps/income\\_pop55/2000/sect7.pdf](http://www.ssa.gov/policy/docs/statcomps/income_pop55/2000/sect7.pdf)

# THE VALUE OF SOCIAL SECURITY

- Inflation protection
- Life Insurance
  - \$403,000 for a young family
- Disability Insurance
  - \$208,000 for a young family
- Portable Retirement protection
- Only plan for 6 out of 10 private sector employees
- Progressive benefit structure
- Freeing up the generation in the middle to concentrate resources on their children

# BENEFITS-JANUARY 2005

## ■ AVERAGE BENEFITS

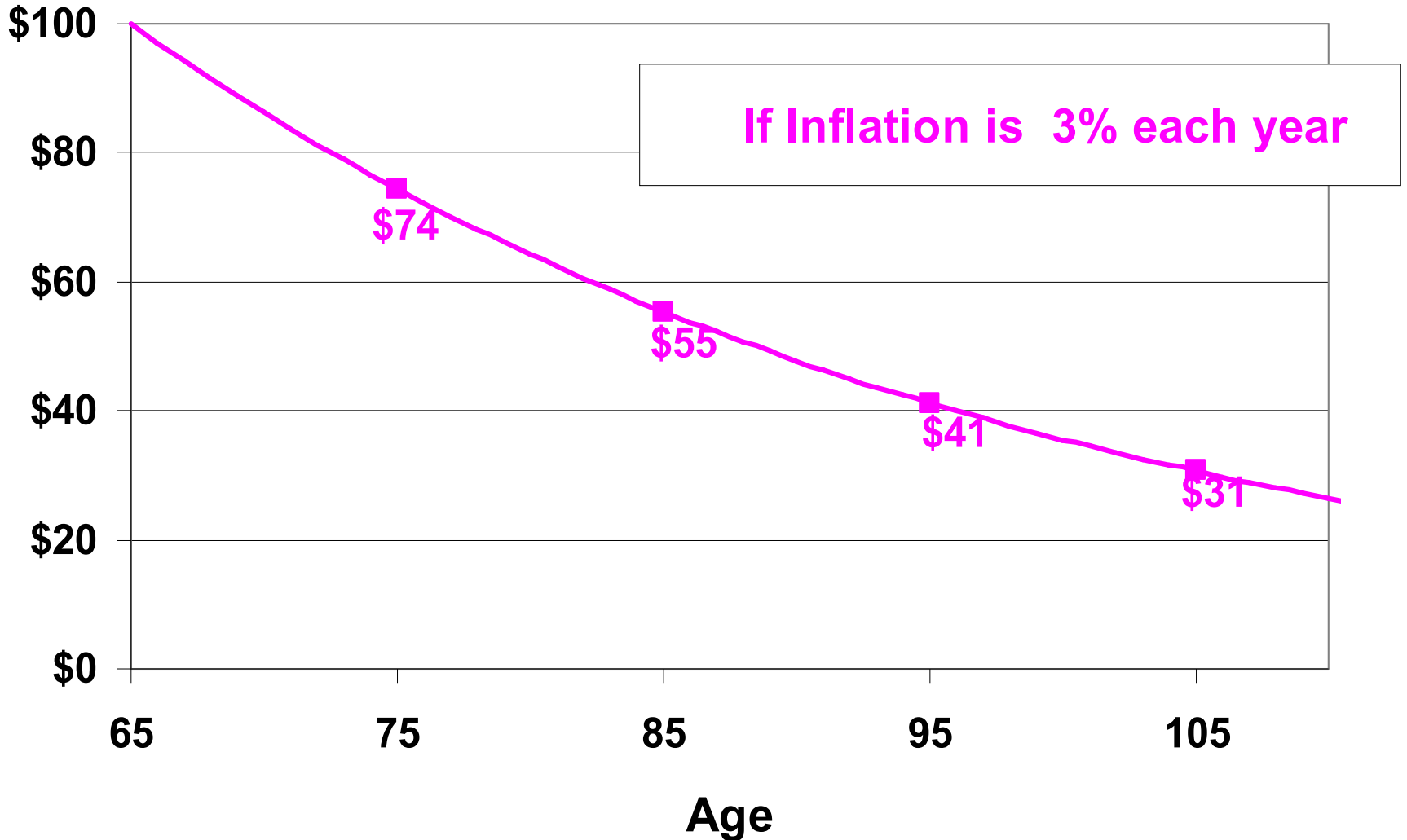
- \$955 FOR RETIRED WORKERS
- \$895 Disabled Workers
- \$1,574 FOR AGED COUPLE
- \$920 FOR AGED WIDOW(ER)
- \$1,979 WIDOWED MOTHER WITH 2 KIDS
- \$1,412 DISABLED WORKER, SPOUSE & KIDS

## ■ MAXIMUM BENEFIT

- \$1,939 FOR WORKER REACHING FULL RETIREMENT AGE in 2005 (65 & 6 months)

# Without the COLA

## Purchasing Power is Reduced by Inflation



# **THE BENEFIT FORMULA (2005)**

**Proportionately larger benefits for long-term low wage earners**

**But larger benefit amounts for those who pay more into the program**

**Gives expression to dual goals of adequacy and individual equity**

**90% of first \$627**

**32% of next \$3,152**

**15% of excess**

# African-American & Hispanic Workers

- **Make up a disproportionate segment of low and moderate wage earners**
- **Social Security benefit formula ensures all lower-wage workers receive a higher replacement relative to their earnings**





# Women compared to Men

|  | <u>Men</u>      | <u>Women</u>    |
|--|-----------------|-----------------|
| <b>Median earnings of full-time workers (2002)</b>               | <b>\$38,884</b> | <b>\$29,680</b> |
| <b>Median years of covr'd emplymt by workers retiring (2000)</b> | <b>44</b>       | <b>32</b>       |
| <b>Life expectancy at age 65</b>                                 | <b>16.6</b>     | <b>19.6</b>     |

Source: Center for Retirement Research, *Why Are So Many Older Women Poor?*, by Alicia H. Munnell, April 2004 & AARP



# FINANCING SOCIAL SECURITY



# **FINANCING SOCIAL SECURITY**

**(Calendar year 2004 estimates)**

- **Payroll Taxes \$569 billion**
  - 6.2 % payroll tax on employees & employers
  - \$87,900 ceiling in 2004
- **Taxation of benefits \$14 billion**
- **Trust Fund Investments \$97 billion**
- **155 million taxpayers**
- **Receipts \$ 642 billion**
- **Disbursements \$499 billion**
- **Surplus \$181 billion**
- **Trust Fund Assets 1.7 trillion at year's end**
- **Administrative costs 0.9%**

# Key Solvency Dates

**2018**

Tax revenues not sufficient to meet all obligations  
Begin relying on interest income but OASDI still running surplus

**2028**

Begin redeeming bonds in trust funds

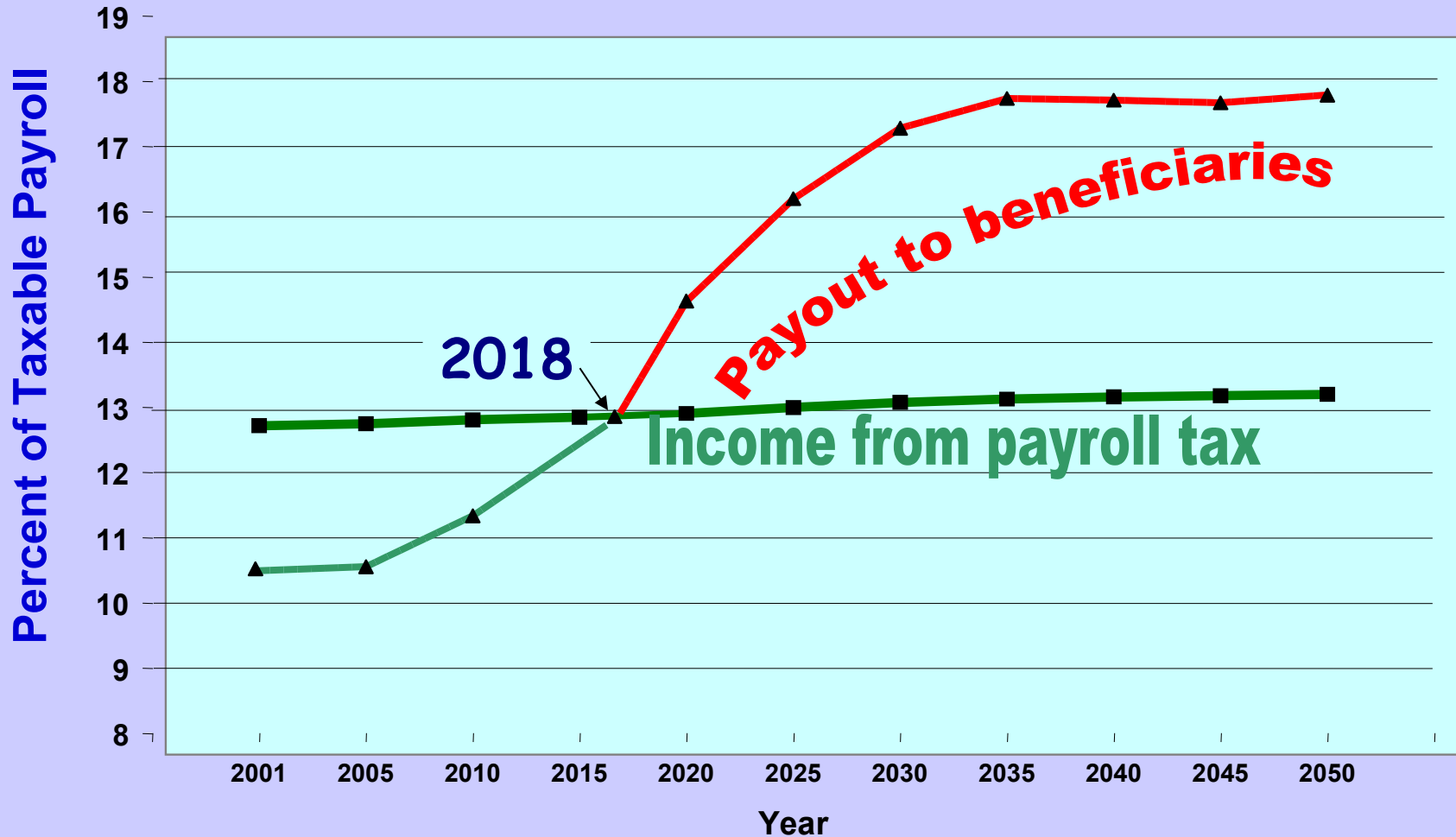
**2042**

Trust funds depleted, but incoming revenues can pay about 70%

**2052**

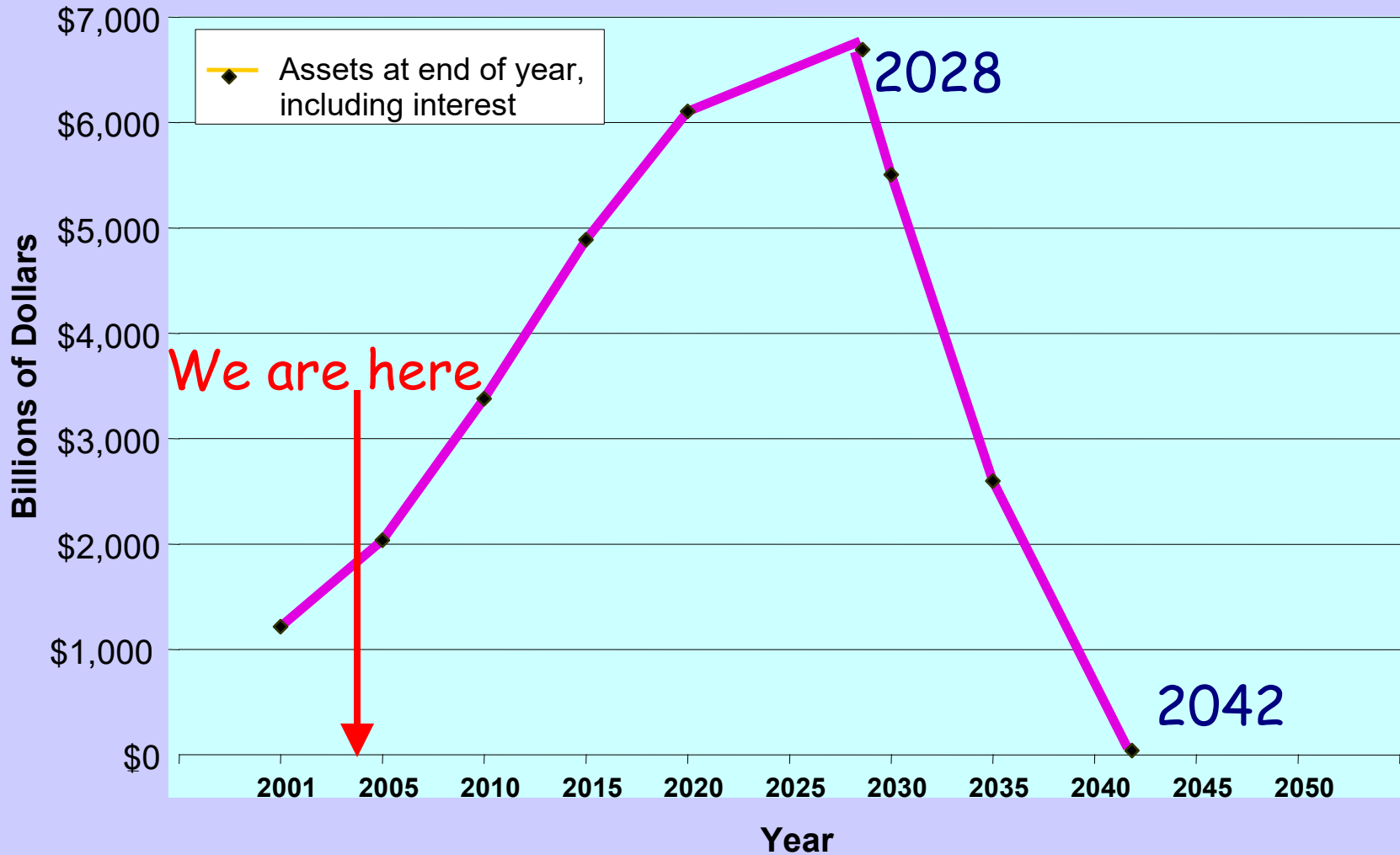
Congressional Budget Office estimates fully funded until 2052

# Social Security: Cash Flow

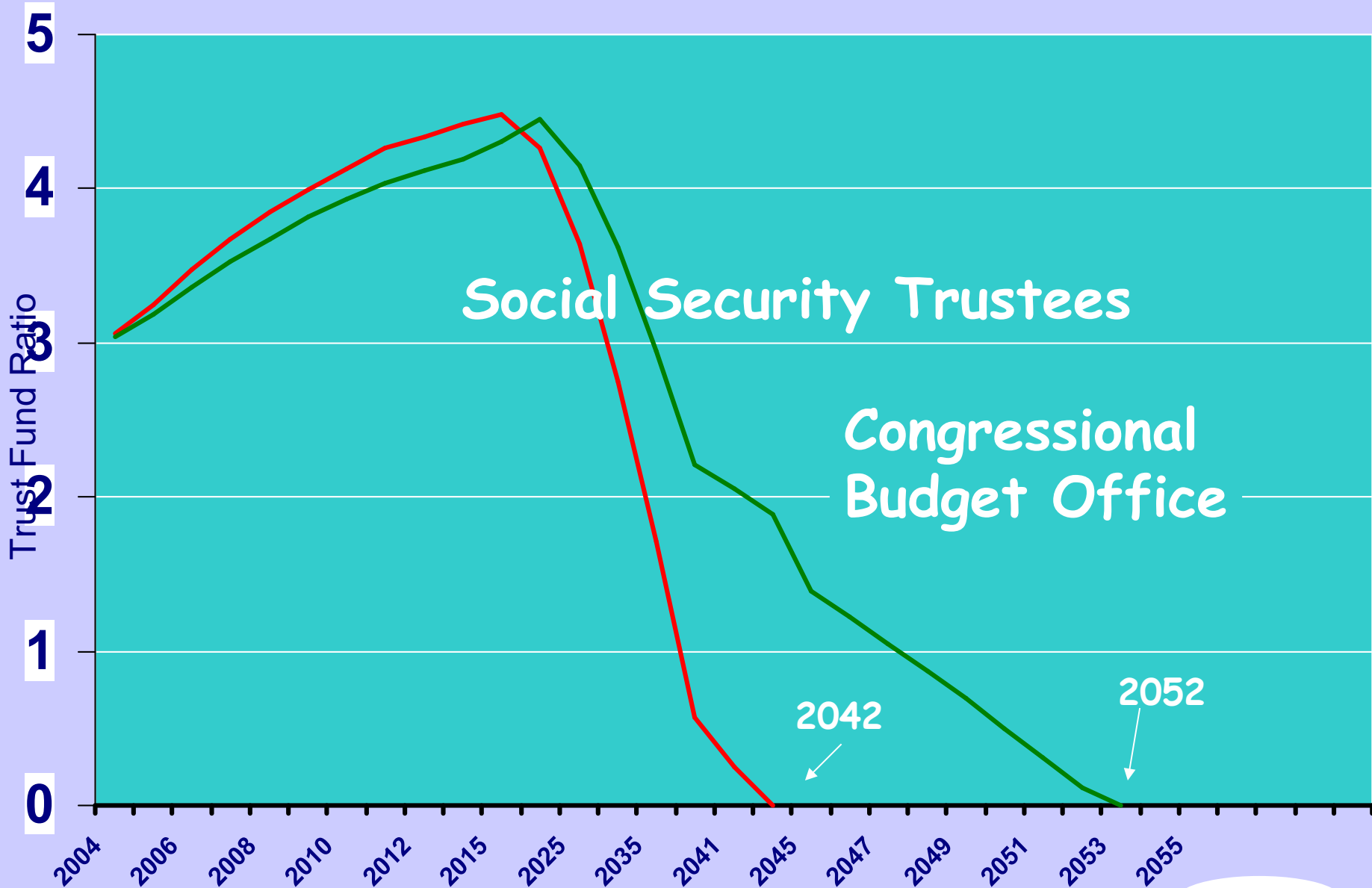


**Estimated OASDI and Cost Rates, 2001-50**  
[as a % of taxable payroll]

# Social Security: Projected Trust Fund Assets (in current dollars)

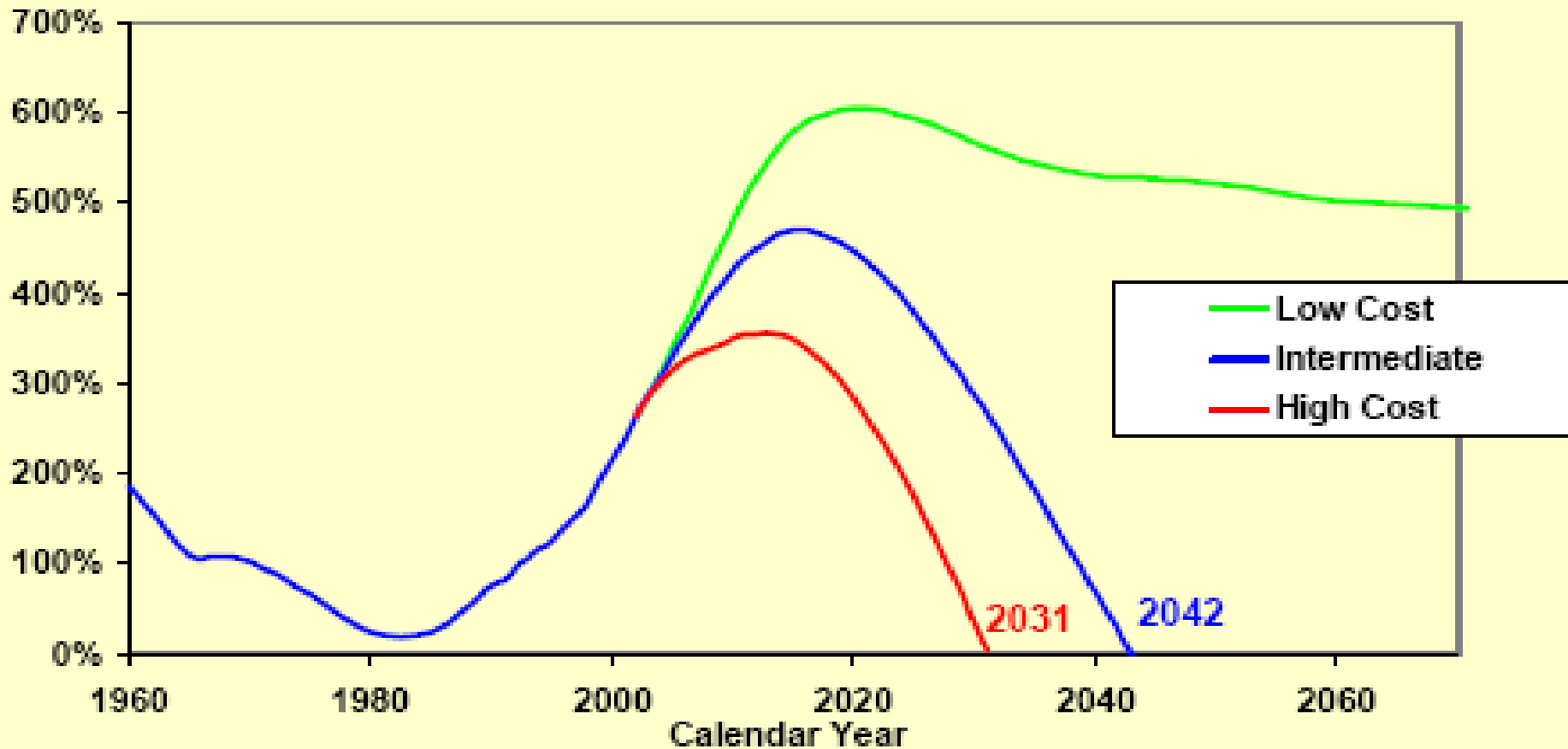


# Social Security: 2 Projections of Trust Fund Assets (Numbers as a ratio of balance to outlays)



# Social Security Trust Fund Ratios

(Beginning of Year Assets as a % of Expenditures)



AMERICAN ACADEMY OF ACTUARIES

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American Academy of Actuaries  
Social Security Briefing - Traditional System 4

Accessed from: [http://www.actuary.org/pdf/socialsecurity/briefing\\_041604.pdf](http://www.actuary.org/pdf/socialsecurity/briefing_041604.pdf)

Prepared by Heather Jerbi



***What is causing  
the financing  
problem?***

# Causes

## Changing Demographics

The Aging of the Baby Boom

Mortality improvements

Low fertility rates

## Increased Earnings Inequality

## Legacy Debt

## Changes in actuarial assumptions

Real wage growth

Mortality

Improved method of estimating value of benefits

# THE AGING OF THE BABY BOOM



# Summarizing the financing problem

**It's real**

**Manageable**

**Should not ignore**

**Should not exaggerate**

**Does not require radical change**

**Fully funded until 2042**

**Over 70% funded after 2042**

# The Choices



# Moderate Reform

## Traditional Supporters

Manageable

Maintain SS

Modest tax increase

Modest benefit cuts

Moderate adjustments

*Social protections*

*Shared risk*

*Community responsibility*

# Radical Change

## Traditional Opponents

Crisis Rhetoric

Privatize

No tax increases

Large benefit cuts

Large Transition Costs

*Ownership*

*Individual risk*

*Smaller government*

# Many reasonable solutions

- all require some pain
- no need for radical change

# Options to Strengthen Social Security

| POLICY OPTIONS | % |
|----------------|---|
|                |   |
|                |   |
|                |   |
|                |   |





# Ball Plan

(% of Problem Solved)

**Raise the tax ceiling to cover more of what high-income earners make (32%)**

**Fix the cost of living adjustment (16%)**

**After 2010 maintain estate tax on estates over \$350,000 & dedicate to SS (16%)**

**Failsafe payroll tax increase of 0.9 % on employee and employer a portion of which might take effect around 2055**

**(assures balance well beyond 2080)**

# OTHER REFORM OPTIONS

(% of Problem Solved)

Increase payroll tax by 0.50% on employer & employee, in 2020 (25%)

Tax SS like private pensions (20%)

Include new state & local workers (10%)

Apply FICA tax to employers' entire payroll (50%)

Maintain real 1997 ben. values & gradually cut replace. rates by 5% (16%)

Compute benefits over 38 years (13%)

Index NRA to increases in longevity after 2026 (14%)

Accelerate NRA increase to age 68 by 2020 (25%)

# **President's Principles**

**No Tax Increases**

**No Changes for Current Beneficiaries &  
55+**

**Under 55**

**Shift to Wage Indexing Earnings  
Voluntary Private Accounts**

# **BUSH “PLAN”**

***(not yet fully described)***

**Move toward defined contribution plan**

**Personal accounts in**

**Most likely 4% optional carve out**

**No tax increases**

**Borrowing to fund large transition costs**

**No cuts in benefits for seniors and older workers (55+)**

**Shift from wage indexing to reduce OASDI shortfall**

**Very large cuts & unspecified cuts on young**

# Why is the Wage Indexing So Important?

It assures stable income replacement rates over the lives of workers

- 56% low-wage workers
- 42% average-wage workers
- 35% high-wage workers
- 30% consistent maximum-taxable wages

Maintains parity with improvements in living standards over the lives of workers at different earnings levels

# ***Cuts from Bush privatization plan***

## **Phases in cuts over time**

**15% cut in guaranteed benefits of 45 year old worker**

**25% cut in guaranteed benefits of 35 year old worker**

**40% cut in guaranteed benefits of 15 year old**

**\$160,000 loss over retirement**

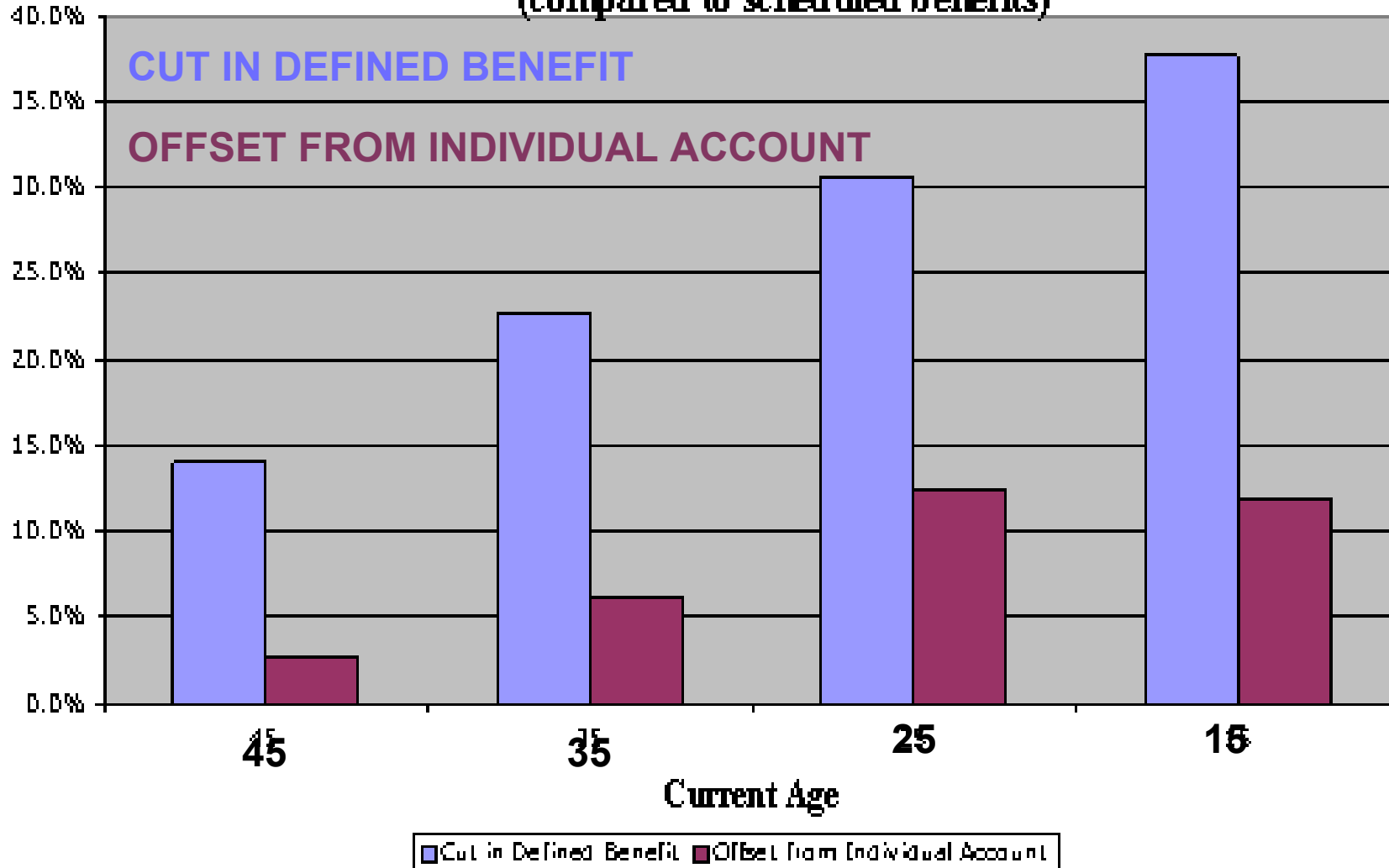
**Private accounts will not offset loss from benefit reductions**

**All things being equal, this 160,000 loss would only be offset by \$50,000 from savings in the private account**

**Source: Dean Baker & David Rosnick, Center for Economic and Policy Research**

# Imaginary Stock Returns Don't Offset Real Benefit Cuts

## Benefit Cuts Under the Bush Proposal (compared to scheduled benefits)



# PROBLEMS WITH PRIVATIZING

- **Transition costs: large benefit reductions, tax increases & possibly borrowing**
- **Administrative costs & fees**
- **Exacerbates inequalities and uncertainties**
- **Shifts risks from government to individuals**
- **Market volatility**
- **Negative interactions with employer pensions**
- **Special risks for low & moderate income**
- **Inflation risks**
- **Undermines political support for redistributive goals**
- **Risk that a Congress will allow accumulations to be used for non retirement purposes**
- **Interactions of politics & financial markets**



**THE VALUES SERVED BY  
SOCIAL SECURITY:  
*The moral basis***

**An Expression of Community**

**Mutual Aid & Self-Help**

**Concern for Neighbors**

**Dignity**

**Faith in Democracy & Government**

**Compact between Generations**

# Join the march... to OLD AGE SECURITY



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**HOW TO BEGIN APPLICATION**

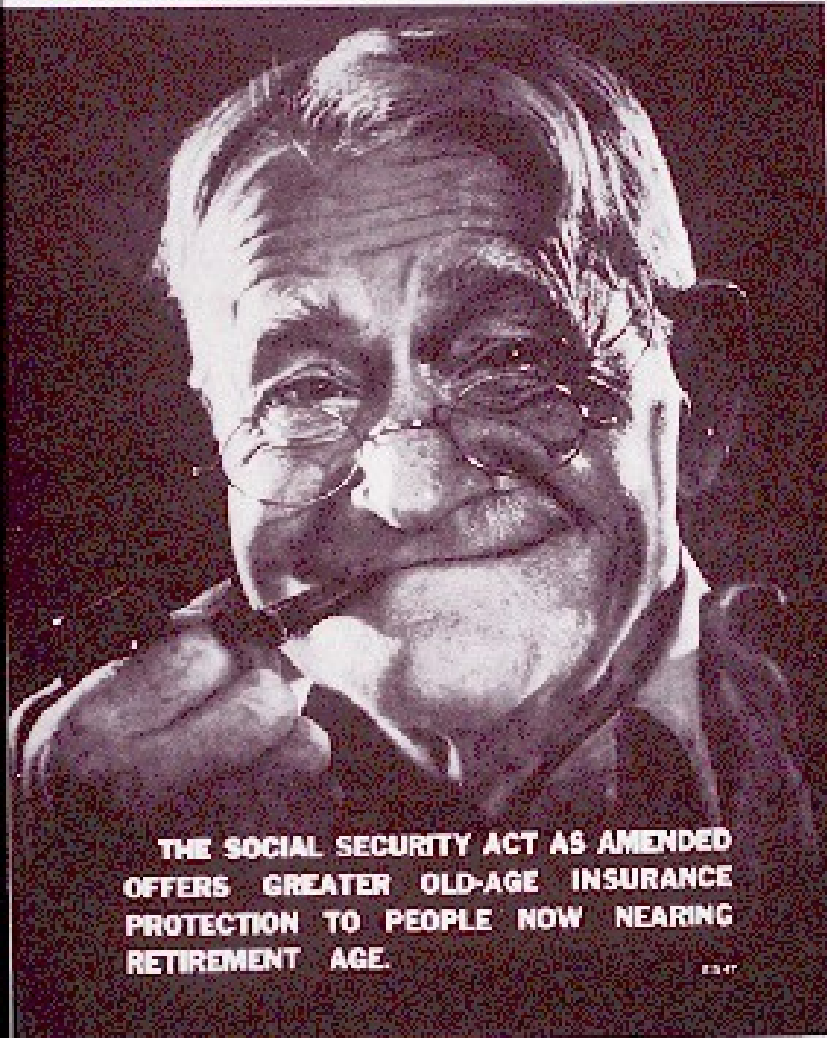
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SS-47

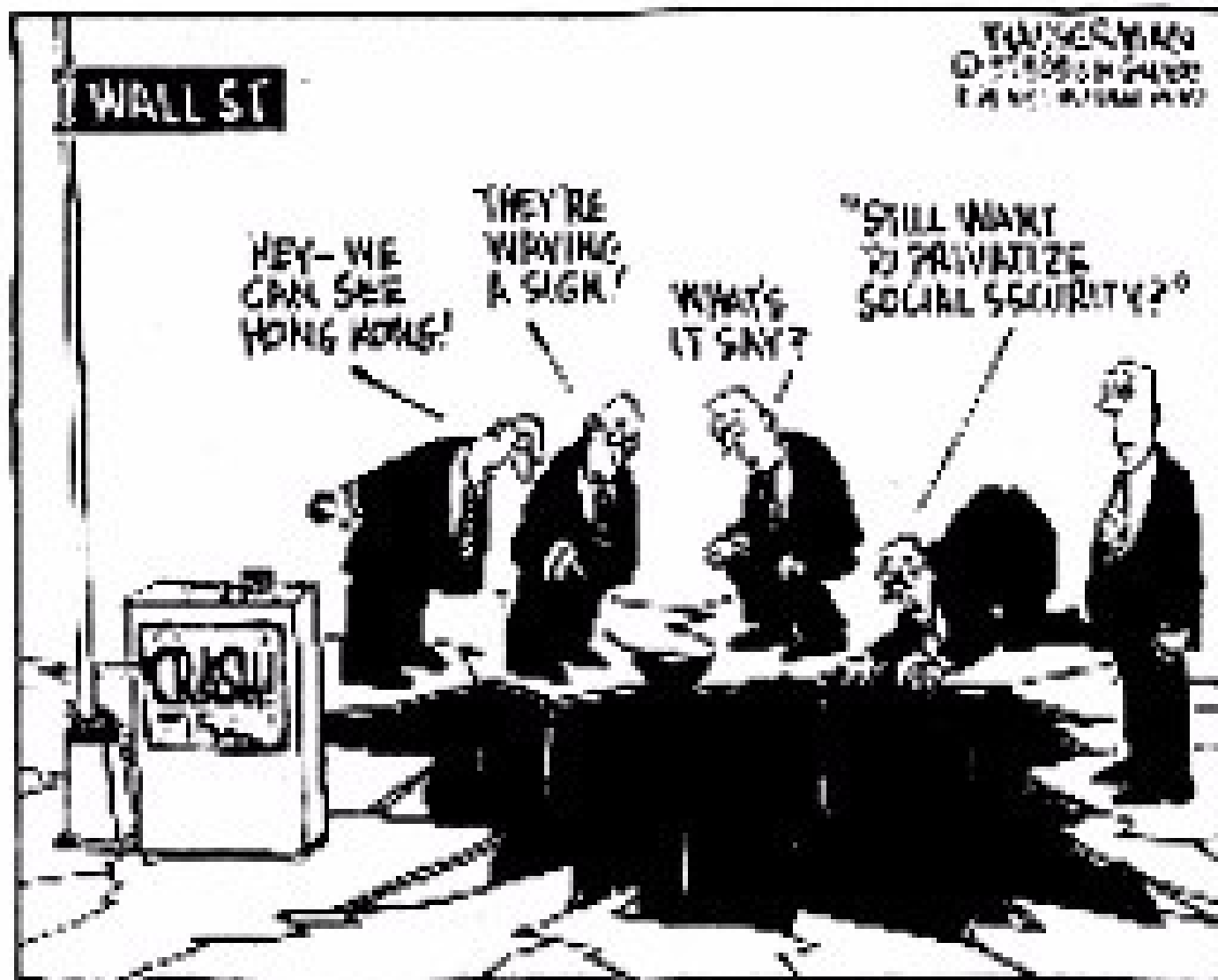
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# **End talk here**

**Slides that follow are in no particular order.**

**Left them because you might find some of interest**

# Wasserman's view



**A good place to learn more about Social  
Security Policy Options**

**Play the American Academy of Actuaries**

**SOCIAL SECURITY GAME**

**<http://www.actuary.org/socialsecurity/>**

[http://www.actuary.org/pdf/socialsecurity/briefing\\_041604.pdf](http://www.actuary.org/pdf/socialsecurity/briefing_041604.pdf)

# Consider

- Trade-offs
- Every option distributes pain
- How to vulnerable groups fare?
- What's fair?
- What's politically feasible?
- Which groups are at greatest risk?
- How should the problems older women be addressed?

# **In addressing the financing problem, recognize**

- **Who wins & loses**
- **Risks to most vulnerable**
- **Diversity of Baby Boom**
- **Need to spread the pain**
- **Cross-generational implications**
- **Value of universal protection**
- **Moral Basis of Social Security**

# Possible Advantages of Individual Accounts

- Give workers ownership and control
- Potentially greater return on contributions
- Address Social Security's long-term deficit
- Help economy raise investment capital
- More individual equity





# Possible Disadvantages of Individual Accounts

---

- High “transition costs”
- Increase risks to workers and families
- Increase administrative costs
- Cut benefits for lower-paid workers
- Burden on other social programs if workers make poor decisions

# Designing Individual Accounts: 10 Key Issues

- Should IAs be mandatory or voluntary?
- How to keep benefits adequate for low-paid workers?
- How to grandfather older workers and retirees?
- How to preserve disability benefits?
- Should all individual accounts be managed centrally?
- What investment choices should workers have?
- How can workers make informed investment decisions?
- Should workers have access to funds before retirement?
- Should payout annuities be mandatory or voluntary?
- How to design and administer payout annuities?

# **Diamond/Orszag Reform**

## **Adjustments for Increased Life Expectancy**

Adjust benefits (13%)

Adjust revenues (15%)

## **Adjustments for Increased Earnings Inequality**

Increase taxable earnings base (13%)

Reduce benefits for higher earners (9%)

## **Adjustments for Fairer Sharing of Legacy Costs**

Make Social Security coverage universal (10%)

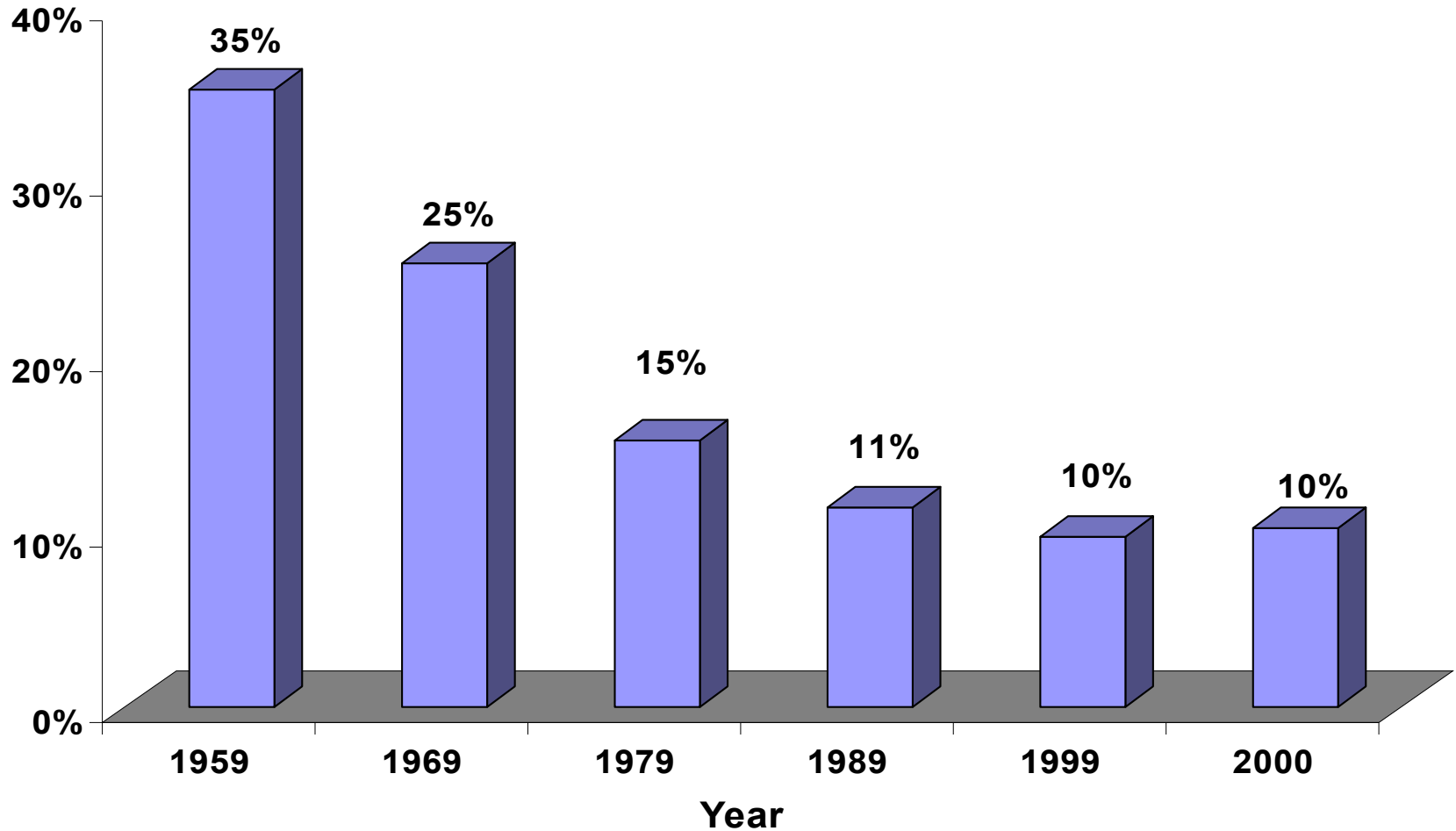
Impose legacy tax on earnings over taxable maximum (29%)

Impose legacy charge on benefits and revenues (51%)

## **Benefit Improvements for At-Risk Populations**

*Estate Tax*

# Poverty Rates For People Age 65 and Over

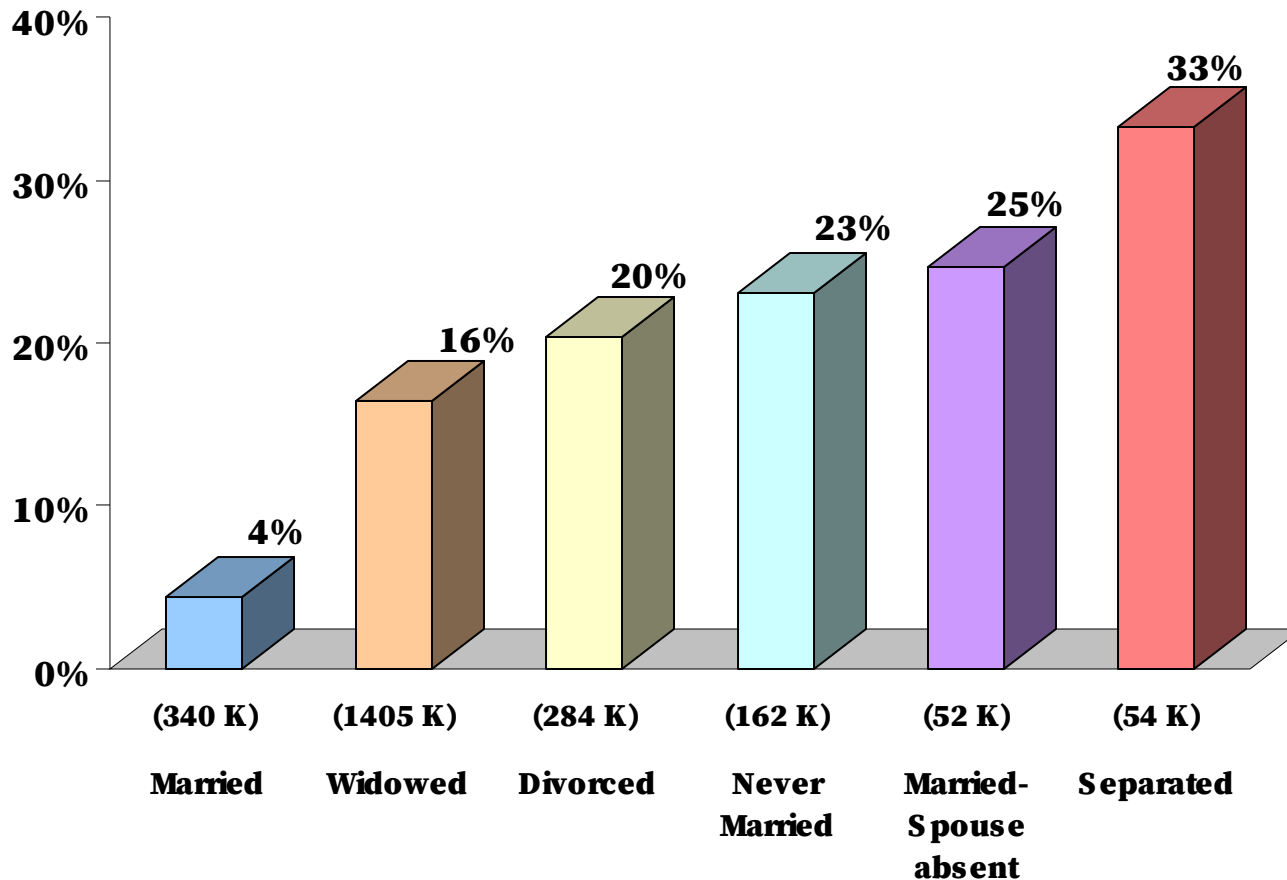


Social Security (along with SSI , Pensions, etc.) decreased the percent of elderly below the poverty level to the same % as those for people of working age! The poverty threshold (for people over 65) is currently about \$8,000 per person (~ \$10,000 for a couple). The thresholds increase with CPI-U (which is subject to criticism). Source: US Census Bureau's CPS (Current Population Survey) and [ferret.bls.census.gov](http://ferret.bls.census.gov)

*Downloaded from: American Academy of Actuaries website*

[www.actuary.org](http://www.actuary.org)

## **2000 Poverty Rates of Women Age 65 & Over** **(and Number in Poverty)**



### **Marital Status**

Reflecting home ownership reduces elderly poverty rates by 5% (10% for elderly widows). Reflecting MOOP (medical out-of-pocket) expenses increases them. Recommendation to reduce single's threshold from 79% to 71% of couple's threshold (Betson & Intl or 62% per NAS) lowers single rates towards married rates. Experimental measures increased poverty rates of married couples by 4%, but changed widows little (BLS: Johnson 2/2000). Source: Current Population Survey March 2000 Supplement (using ferret.bls.census.gov)

**Fairness**

# African-American & Hispanic Retirees

- Life-expectancy at birth still significantly lower for males of these groups
- Life expectancy at 65 is only somewhat over a year's difference, and the gap is closing
- A shorter life span means a person contributes to Social Security without receiving as many years of retirement benefits, yet:
  - a higher % get disability benefits
  - a higher % get survivor benefits



# Women's Equity Issues

- Women concentrated in low-wage work
- Median weekly salary = \$531 vs \$685 (78%)
- Over half of beneficiaries are women
- For 1 in 4 unmarried women, sole source of income is Social Security
- Women live longer: 3 more years at 65
- COLA crucial to well-being of longest lived
- Women (and men) get the higher of:
  - Spousal benefit
  - Or, own work earnings





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# Options

- Decrease Benefits
  - Raise retirement age (to 67 faster & index)
  - Reduce COLA by ½%
  - Cut initial benefits by 1% each year
  - Affluence Test (Concord)
  - Increase # of yrs in wage avg. to 40
- Increase Taxes
  - Increase tax rate by 1% in total
  - Increase wages subject to tax by 1/4
  - Tax SS benefits like pensions
  - Include rest of state & local govt.
- Increase Investment Returns
  - Investment in equities

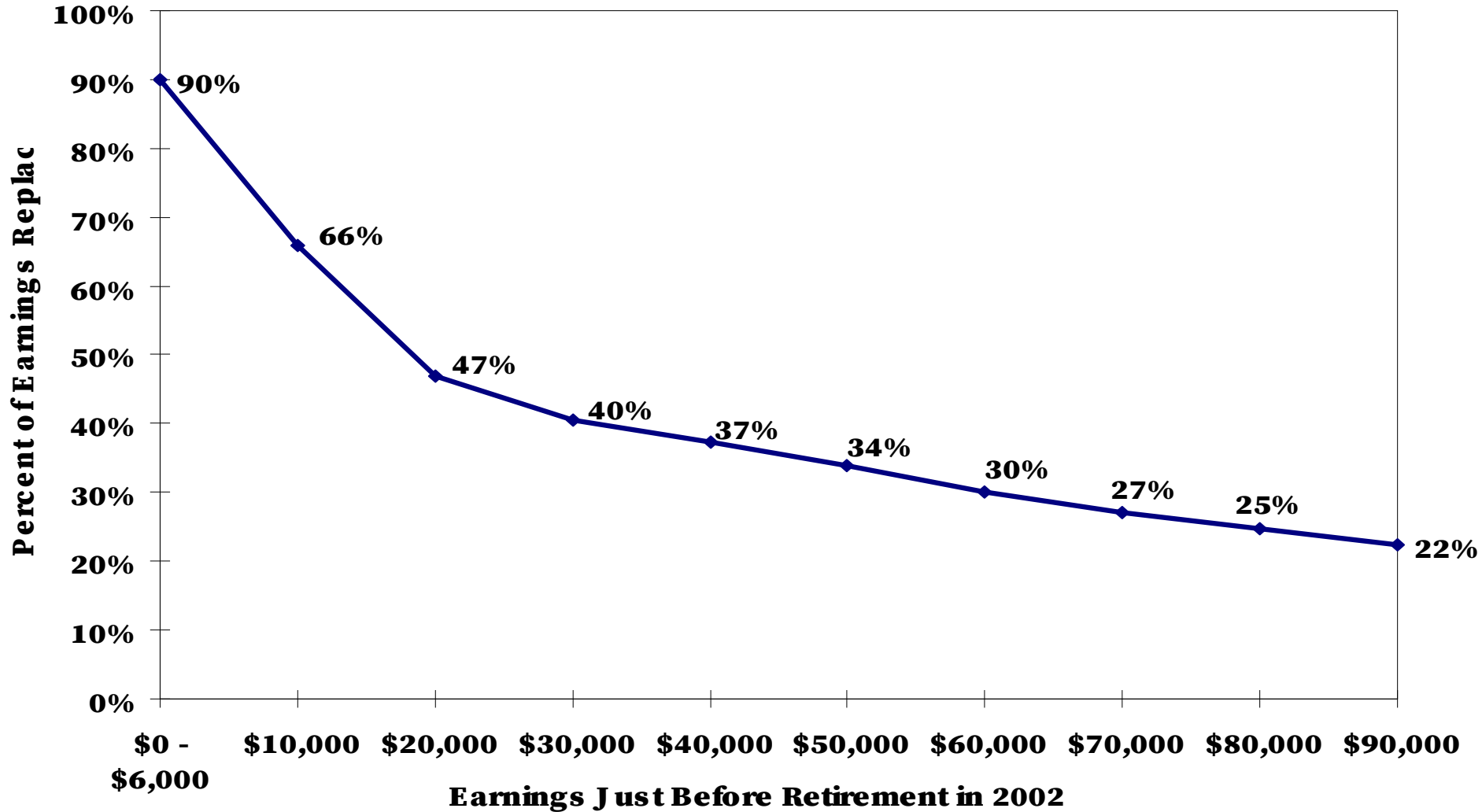
| % of Deficit Eliminated |          |
|-------------------------|----------|
|                         | 33%      |
|                         | 41%      |
|                         | 100%     |
|                         | 75%      |
|                         | 21%      |
|                         |          |
|                         | 51%      |
|                         | 26%      |
|                         | 20%      |
|                         | 10%      |
|                         |          |
|                         | 36%- 50% |



# Five moderate changes address problem

- Cover New State & Local Employees 11%
- Compute benefits over 38 years 13%
- Tax benefits like contributory private pension benefit plans and phase out thresholds (\$25,000/32,000) for taxation of benefits - 16%
- Increase taxable earnings ceiling by about 18%  
- 19%
- Invest 40% of trust fund assets in equities 43%

# Social Security Replacement Ratios at Normal Retirement Age (and at Disability)



See History of Provisions at [www.ssa.gov/OACT/HOP](http://www.ssa.gov/OACT/HOP). Past wages based on National Average Wage Index  
These percentages increase by about 1 to 2 percentage points over the next 10 years, per Table VI.E11 in 2002 rpt.

# The Ownership Society

WE BROKE IT.  
YOU OWN IT.

Social

Security

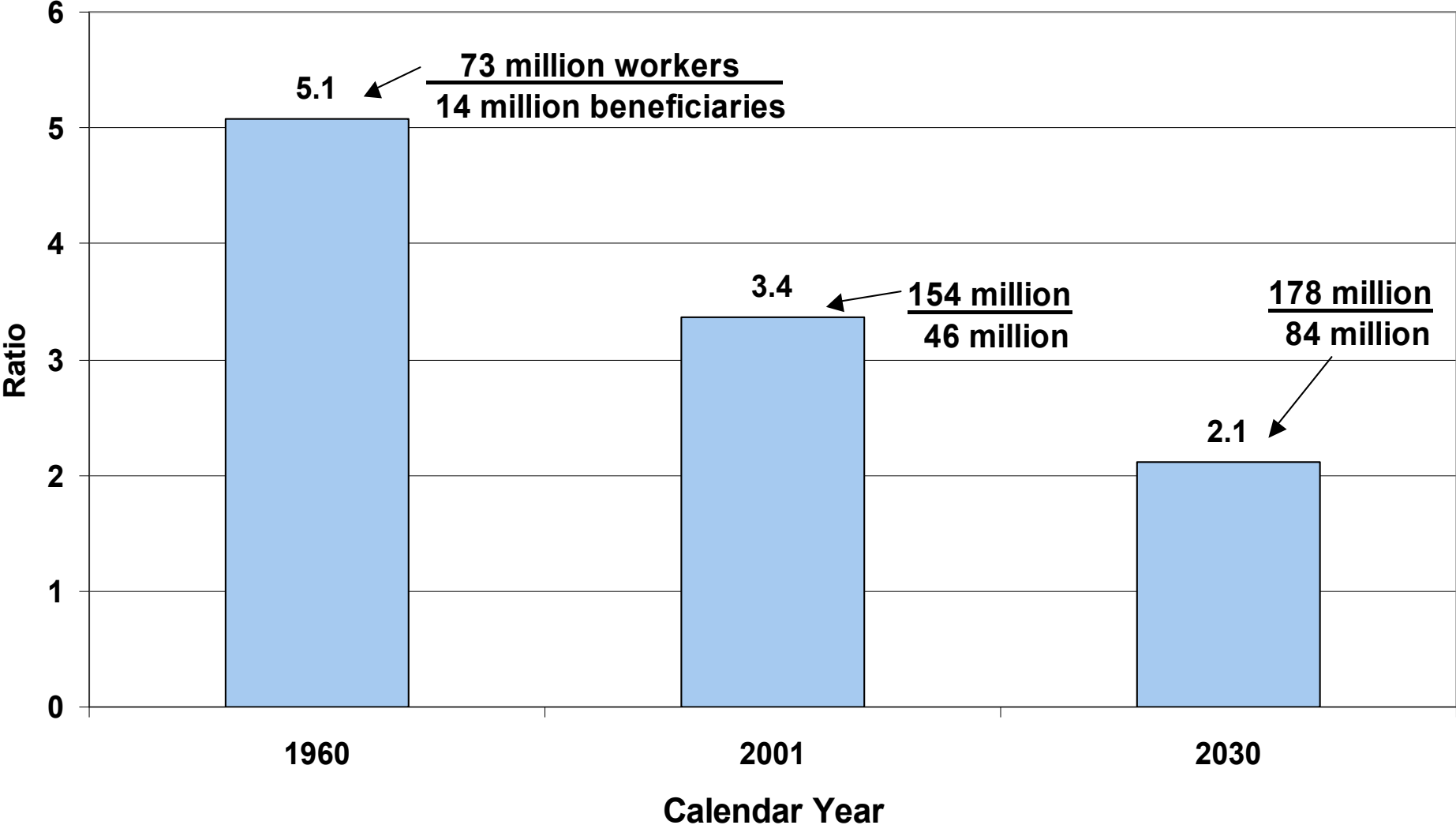
TRUST FUND,  
BUT VERIFY. —

TALS

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Source: Tom Toles, Washington Post

# Workers per Beneficiary



The number of workers supporting beneficiaries decreases dramatically due to baby boomers & longer lifespans. Source: 2002 SSA Trustees' Report, Table IV.B2

# Multiple Goals & Assessment of Fairness

- Adequacy
- Social goals
- Individual equity/rate of return
- Human Dignity
- Stable financing

