Module 10: Social Security

Table of Contents

Module 10: Social Security

Unit 3: Issues and Global Trends in Social Security

Case Study 05: Does Privatization Provide a More Equitable Solution?

The threat to the stability of Social Security has been apparent for decades. For years, political leaders have agreed that something must be done…. We can postpone action no longer. Social Security is a challenge now; if we fail to act, it will become a crisis. We must save Social Security and we now have the opportunity to do so.

With these words, on May 2, 2001, President George W. Bush established the Presidential Commission to Strengthen Social Security.

The crisis President Bush was referring to is the declining numbers of new workers paying into the Social Security system. Fewer births and longer life expectancies are causes. In 1940, when the first benefits were paid, there were more than forty workers paying for each retiree receiving benefits. In 1960, there were five workers for each retiree. Today, there are 3.4 workers paying for each beneficiary. With the baby boom generation set to retire over the next few decades, that number is expected to fall even further. The Presidential Commission's report estimates that the ratio will be 2.2:1 in 2025 and just 2:1 by 2050.

These demographic changes mean that the burden of paying for Social Security will fall ever more heavily on the younger generation of workers. When polled, 41 percent of young people (ages eighteen to thirty-four) said that they do not expect to receive Social Security benefits at today's level when they retire, while 31 percent expected to receive no benefits at all.

Certainly, current benefit levels cannot be maintained without raising Social Security withholding taxes or extending the normal retirement age. But is it fair to tax younger workers more heavily to pay for their parents' retirement? Will there even be any money left for their own retirement? One solution that has been proposed is individual investment accounts that would allow individuals to invest a percentage of their Social Security savings themselves. Proponents of privatization argue that it would allow greater returns than the traditional Social Security system. In the heady days of soaring stock prices and budget surpluses, just before President Bush created the commission, privatization was a popular solution. Workers, it was argued, could invest their Social Security funds in the stock market and see great returns. Low-wage workers would become shareholders in the U.S. economy and be able to accumulate wealth. Money would flow into the economy.

With the economic recession that began in 2008, privatization has lost momentum. But even when the plan was first proposed, it faced opposition on a number of grounds. The pay-as-you-go system is a guaranteed benefit. With many retirees depending on Social Security as their main source of income, this guarantee is crucial. But what happens if an individual invested unwisely? Proponents of a private system argue that an education campaign, along with requirements for diversification and safeguards against high-risk investments, should prevent such losses.

Another argument against privatization is the distortion it could cause in the stock market. With a large number of funds flowing into mutual funds from Social Security investors, prices might be driven up artificially. Government-approved mutual funds would receive a huge windfall in fees. Most young people, who politicians have argued would benefit the most from privatization, do not support changing the Social Security system but would rather see the existing system strengthened. A majority polled say that “making sure that people receive a decent, guaranteed monthly retirement benefit” is a higher priority than “making sure that people receive a better rate of return.”

Questions for Discussion

1. Who should be responsible for the welfare of the retired population? The current workers or the retirees (who should save for it)?
2. Is it appropriate for the government to mandate forced savings in private accounts in lieu of the pay-as-you-go Social Security system? Would this action change the nature of the requirements from taxes to private saving?

3. If part of the individual accounts would be administered by the government, is it ethical for the government to essentially become a major shareholder in private companies?

Sources:

- Key findings from Hart Research Poll, July 24, 1998; "Young Americans and Social Security: A Public Opinion Study Conducted for the 2030 Center by Peter D. Hart, Research Associates," July 1999, accessed April 5, 2009,http://www.commondreams.org/pressreleases/july99/072299a.htm;
- President's Commission to Strengthen Social Security, "Final Report: Strengthening Social Security and Creating Personal Wealth for All Americans," December 21, 2001 (this document includes all appendixes and Estimates of Financial Effects for Three Models Developed by the President's Commission to Strengthen Social Security, prepared by the Office of the Chief Actuary, Social Security Administration, May 2, 2001);
- Gary Burtless, "Social Security Privatization and Financial Market Risk," Center on Social and Economic Dynamics, Working Paper No. 10, February 2000; Social Security Administration, "Little Change in Social Security Solvency (Trustees Recommend Timely Action)," March 23, 2005, accessed April 5, 2009.

Module 10: Social Security

Unit 3: Issues and Global Trends in Social Security

Case Study 06: The Future of Social Security

The Future of Social Security

A quick glance at Figure 18.3 "Long-Range OASI and DI Annual Income Rates and Cost Rates (as a Percentage of Taxable Payroll), Trustees Report 2008" shows that the costs of Social Security are rising faster than the payments into the system. In the 2008 Annual Report to Congress, the Trustees announced the following:

- The projected point at which tax revenues will fall below program costs comes in 2011
- The projected point at which the trust funds will be exhausted comes in 2041
- The projected actuarial deficit over the seventy-five-year, long-range period is 3.54 percent of taxable payroll
- Over the seventy-five-year period, the trust funds require additional revenue, equivalent to $4.3 trillion in today’s dollars to pay all scheduled benefits.

Figure 18.3 "Long-Range OASI and DI Annual Income Rates and Cost Rates (as a Percentage of Taxable Payroll), Trustees Report 2008" and Figure 18.4 "OASDI and HI Income Shortfall to Pay Scheduled Benefits, and the 75 Percent General Fund Revenue Contribution to SMI (Percentage of GDP), Trustees Report 2008"are from the 2008 OASDI Trustees Report on the current and projected financial condition of all the Social Security programs. (The six trustees of the board are the Secretary of the Treasury, the Secretary of Labor, the Secretary of Health and Human Services, the Commissioner of Social Security, and two members appointed by the president.) The programs are financed through four separate trust funds: the Old-Age and Survivors Insurance (OASI) Trust Fund, Disability Insurance (DI), and two for Medicare.

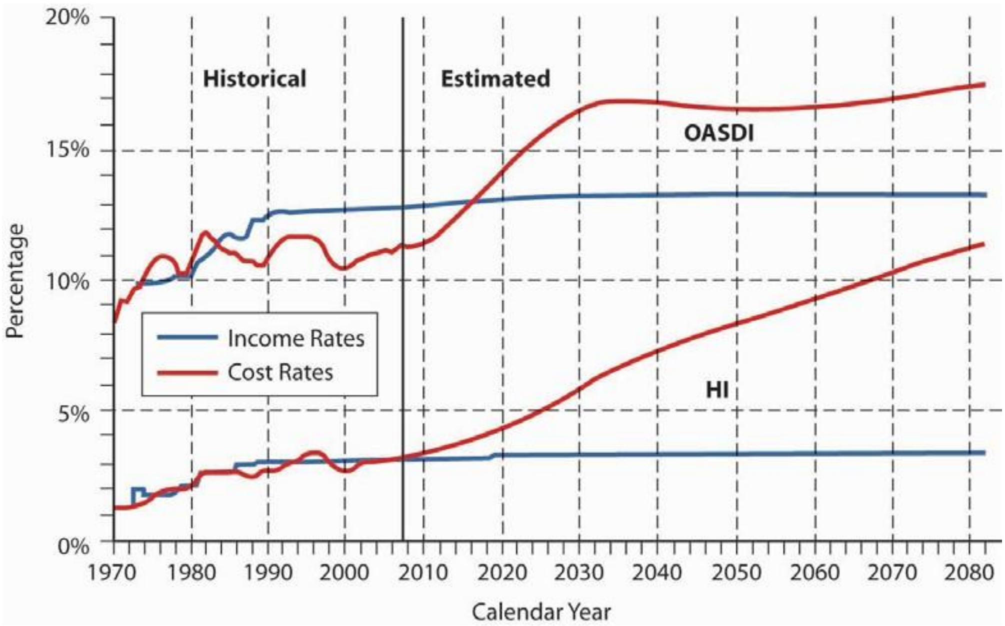
To project future effects on the bottom line, the trustees review available evidence and gather expert opinion about all the factors that affect income and expenditures: demographic (birth rate, mortality, immigration); economic (unemployment rates, inflation); and program-specific (retirement patterns, disability incidence). The trustees make both short-range (ten-year) and long-range (seventy-five-year) predictions.

Traditional solutions to the looming Social Security and Medicare budget crisis have focused on increasing these taxes and cutting benefits. President G. W. Bush, in his State of the Union address on January 31, 2006, called for a bipartisan committee to find a solution to the impending major shortfall as the baby boom generation begins retirement. President Bush and many members of Congress believed the answer was privatization—allowing workers to invest some or all of their own (private) Social Security funds in the stock market, which historically yields greater returns over long investment periods than Treasury securities do. Beliefs in an ownership society and personal responsibility lie behind this objective. After Chile's successful move to privatization in 1981, almost every South American country has followed suit, with positive results. Countries from Singapore to Hungary have also converted successfully. With the economic recession of 2008 and the arrival of a new administration, focus has shifted from Social Security as a major political issue. But there are many arguments on both sides, and it remains to be seen how the Social Security system will be preserved.

Sources:

- Merrill Matthews, Jr., "A 12-Step Plan for Social Security Reform," National Center for Policy Analysis, June 4, 1998,http://www.ncpa.org/ba/ba267.html (accessed April 4, 2009);
- Social Security Administration, the 2008 OASDI Trustees Report, June 11, 2008, http://ssa.gov/OACT/TR/TR08/trTOC.html(accessed April 4, 2009).

Figure 18.3 Long-Range OASI and DI Annual Income Rates and Cost Rates (as a Percentage of Taxable Payroll), Trustees Report 2008



Source: Social Security and Medicare Board of Trustees, "A Summary of the 2008 Annual Reports," April 22, 2008,http://www.ssa.gov/OACT/TRSUM/trsummary.html (accessed April 5, 2009).