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AFRICAN AMERICANS' LARGE STAKE IN THE SOCIAL SECURITY DEBATE¹

By William Spriggs and Jason Furman

Social Security is a critical program for African Americans. Nearly five million African Americans receive Social Security benefits; roughly half of them are retired workers, and the other half are either disabled workers or the spouses or children of disabled, retired, or deceased workers. African Americans benefit disproportionately from several features of the Social Security system:

- Social Security has a *progressive benefit structure*. In other words, it is designed to pay benefits that replace a larger share of pre-retirement earnings for lower-income people than for higher-income people. Since African Americans have lower lifetime earnings than whites, on average, they benefit disproportionately from this feature.
- In addition to retirement benefits, Social Security also provides *disability benefits* to workers who become disabled and *survivors benefits* to the families of deceased workers. Since African Americans are more likely than other Americans to become disabled or die before retirement, they benefit disproportionately from these features as well.

Because of these and other factors, studies have consistently shown that African Americans receive a modestly higher rate of return on their Social Security payroll tax contributions than whites do. Put another way, they receive a little more back in Social Security benefits for each dollar they pay in Social Security taxes than whites do.

Social Security also makes up a larger share of the income of elderly African Americans than of elderly white people. This partly reflects the fact that whites nearing retirement age have almost three times more

in pension and retirement savings on average than African Americans — savings that provide a steady stream of income in retirement.

Private accounts contain none of the features that make Social Security so effective for African Americans, such as a progressive benefit formula and disability and survivors' benefits. Thus, replacing part of Social Security with private accounts would tend to make the program less favorable for African Americans. As a Government Accountability Office (GAO) study concluded, "tying [Social Security] benefits more directly to contributions" — as private accounts do — "may affect the progressivity of the system and [is] likely to disproportionately affect equity for minorities."

African Americans Benefit from Progressive Benefit Structure

African Americans have significantly lower average lifetime earnings than non-minorities. Under Social Security's progressive benefit structure, therefore, they receive Social Security benefits that replace a larger share of their pre-retirement earnings than non-minorities do. African American workers earn 73 percent as much as white workers, on average, but their average monthly Social Security retirement

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benefit is about 85 percent as much as white workers' average monthly benefit.

African Americans also benefit from the fact that Social Security benefits are based on a worker's highest 35 years of earnings. (Earnings in other years are disregarded.) Because African Americans have double the unemployment rates of whites and experience longer average spells of unemployment, they have more years with no earnings than whites do, on average. By *not* counting some years of little or no earnings in calculating benefits, Social Security benefits African Americans.

Disability and Survivors Benefits Particularly Important to African Americans

Social Security insures American workers and their spouses and children against the loss of income if a worker is unable to work full time because of disability or death. These benefits, which account for roughly 30 percent of all Social Security benefit payments, are of particular importance to African Americans:

- African American workers are more likely than workers as a whole to become disabled before reaching retirement age. African Americans constitute 11.5 percent of all workers who are covered by Social Security but 17.6 percent of Social Security disability beneficiaries.
- African Americans also are more likely than other workers to die before reaching retirement age. As a result, Social Security survivors' benefits go disproportionately to African Americans. While 15 percent of all U.S. children are African American, 23 percent of the children receiving Social Security survivors' benefits are.

Social Security disability and survivors benefits can be quite substantial. A family of a worker earning average wages who becomes disabled or dies can receive roughly \$350,000-\$400,000 in benefits over the course of a number of years.

African Americans Earn Higher Rate of Return from Social Security

The Social Security program itself is race blind; the benefits it pays are a function of a worker's earnings history and family situation. However, because of the

features of Social Security that are particularly beneficial to African Americans, a wide range of studies from government and academia have found that African Americans receive modestly higher rates of return from Social Security than non-Hispanic whites do. This is true whether one examines just retirement and survivors benefits (not disability benefits), disability benefits alone, or the entire Social Security system (retirement, survivors, and disability benefits together). For example:

- A major Treasury Department study of Social Security retirement and survivors benefits, based on nearly 40,000 actual earnings histories, found that African Americans' average annual rate of return was half a percentage point higher than whites'.
- A study by analysts from the Urban Institute and the Social Security Administration found that African American men receive a 0.3 percent higher average annual rate of return from Social Security disability insurance than non-Hispanic white men. African American women receive a 0.4 percent higher average rate of return than non-Hispanic white women.
- A Government Accountability Office study found that, on average, non-Hispanic blacks receive nearly 10 percent more in Social Security retirement, disability, and survivors benefits for every tax dollar contributed to the program than non-Hispanic whites do. (The gap between African Americans and whites would likely be even larger if the study had counted benefits for children, because African American children are more likely than white children to receive Social Security benefits.)

Private Accounts Especially Risky for African Americans

Private accounts carry risk. Under most leading private accounts plans (including the President's), a worker would have to "repay" Social Security for the funds diverted from the Social Security Trust Fund to the worker's private account, with interest. These repayments would be subtracted from the worker's monthly Social Security retirement benefits.

Robert Shiller, a Yale economist and noted financial expert (and author of *Irrational Exuberance*), has

calculated that under the President's original private accounts proposal, one- to two-thirds of workers who opted for a private account would *lose money* on the deal. That is, they would lose more from the benefit reductions as a result of electing an account than they would receive from the account itself. The funds in a worker's private account would have had to earn three percent above the inflation rate (or nearly six percent overall) on average for the worker to break even.

The Administration later modified its proposal to reduce slightly a worker's risk of ending up worse off, but Shiller's analyses suggest that a substantial portion of workers would still lose money under this approach.

Moreover, the risks of private accounts would be more acute for African Americans than for whites, while the potential rewards likely would be smaller:

- Under a system of private accounts, a worker's earnings early in his or her career are more important than earnings in later years, since once a portion of these earnings is deposited in a private account, it will have more years to grow (due to the compounding of interest) before the worker's retirement. This fact works against African Americans because it is more difficult for young African Americans than young whites to gain a foothold in the labor market. Under Social Security, by contrast, earnings in earlier years are *not* more important than earnings in later years.
- The typical African American earns much less than the typical white with the same level of education. This means African Americans must obtain more education to earn as much as less-educated whites. But those extra years of education are years in which African Americans are not in the labor market — and thus are not contributing to their private accounts.
- African Americans increase their employment rates relative to whites during periods when the labor market is booming. But those tend to be periods when the stock market is higher. This suggests that African Americans would be more likely than whites to make stock market purchases (with funds in their private accounts) at times when stocks cost more. That, in turn,

would tend to lower African Americans' rate of return on their private accounts.

Recent Private Accounts Proposals Would Harm African Americans

Under the President's Social Security plan, initial Social Security benefits would no longer keep pace with increases over time in the average earnings of U.S. workers, and thus in the standard of living. Over time, Social Security benefits would replace a steadily shrinking share of workers' pre-retirement income, causing a larger reduction in workers' living standards when they retired.

Based on African Americans' current earnings, African American workers aged 26-31 today would have their retirement benefits reduced by an average of 10.5 percent under the President's plan. African American workers aged 32-41 today would have their benefits reduced by 7.2 percent, and workers aged 42-54 today would have their benefits reduced by 2.8 percent. While the average percentage cut in benefits would be smaller for African Americans than for whites, the benefit cuts would represent a larger percentage of African Americans' *overall retirement income* because Social Security makes up a much bigger share of retirement income for African Americans than for whites.

Furthermore, the President's proposal would apply the same benefit reductions to survivors benefits as to retirement benefits. The cuts in survivors benefits could prove especially problematic for African Americans, since African American children are more likely to receive survivors benefits — and their parents are less likely to have private life insurance — than white children are.

Some other recent Social Security proposals also would adversely affect African Americans, either directly or indirectly. Among the leading Social Security proposals in Congress are two similar proposals introduced in the summer of 2005 by Senator Jim DeMint and Rep. Jim McCrery. Under these two proposals, private accounts would be limited in size, and contributions to these accounts would be made only through 2016. No changes to Social Security benefits or revenues would be made to reduce Social Security's long-term funding shortfall.

These two proposals rest upon a large budget gimmick. They assume the transfer of hundreds of billions of dollars from the rest of the budget, even though the rest of the budget is projected to be in deficit for as far as the eye can see. Without these large transfers, the proposals would *worsen* Social Security's finances.

Proponents of these two congressional plans have said they regard these small, temporary private account plans as a "foot in the door" to larger, permanent accounts. Paying for larger accounts on an ongoing basis, however, would require either cuts in Social Security benefits or increases in payroll taxes.

Private Accounts Could Weaken Support for Social Security

Private accounts plans could weaken support for Social Security over time, because virtually all of them are designed to make private accounts appear to be a better deal than Social Security.

Under most private accounts proposals, workers who open an account would have their Social Security benefits reduced to repay Social Security for the funds diverted to the account. If large private accounts were permitted, Social Security benefits for millions of middle-and upper-income retirees would be reduced to very low levels. That would make Social Security appear to be a bad deal to many Americans, since they would pay substantial payroll taxes but receive only small Social Security benefits in return. The costs of private accounts *could* have been deducted from workers' private account balances rather than their Social Security benefits, but most private accounts proponents do not favor that because the accounts would then appear less attractive.

Another way in which private accounts plans could undermine support for Social Security is by de-linking Social Security's retirement, survivors, and disability benefits components. Currently, all three components share the same benefit structure. For example, when a worker receiving Social Security disability benefits reaches retirement age, he or she is switched automatically into the retirement component of Social Security; his or her Social Security benefit level does not change.

By contrast, virtually all private accounts plans would sever this link, protecting disability (and, in some cases, survivors) benefits from the full degree of reductions imposed on retirement benefits. As a result, under most private account plans, a person receiving Social Security disability benefits generally would see an abrupt reduction in his or her Social Security benefits upon reaching retirement age. Ultimately, this could drive a wedge between different groups of Social Security beneficiaries and undercut support for Social Security's disability and survivors components, which are so important to African Americans.

Conclusion

Social Security faces a long-term financial imbalance. The Trust Fund is projected to be exhausted in 2041 (according to the Social Security Trustees) or in 2052 (according to the Congressional Budget Office), after which Social Security will be able to pay only about 75 percent of promised benefits. An abrupt reduction in benefits in 2041 or 2052 would harm African Americans disproportionately, since they rely more on Social Security in old age than other groups do. Reforms to restore long-term Social Security solvency are essential.

Making Social Security solvent, however, should not come at the expense of elements of the current system that substantially benefit African Americans. A sensible reform approach that restores solvency in a balanced manner while preserving the most beneficial features of the current system would serve the African American community best.

¹ For a more extensive discussion of these issues and citations for the data and studies mentioned here, see William Spriggs and Jason Furman, "African Americans and Social Security: The Implications of Reform Proposals," Center on Budget and Policy Priorities, January 18, 2006.

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