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SOCIAL SECURITY’S TREATMENT OF
PEOPLE OF COLOR AND WOMEN

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Mr. Chairman and members of the task force, thank you for inviting me to speak. I am Kilolo Kijakazi, a senior policy analyst with the Center on Budget and Policy Priorities. The Center is a nonpartisan, nonprofit policy organization that conducts research and analysis on issues affecting low- and moderate-income families. We are primarily funded by foundations and receive no federal funding.

I will discuss how Social Security’s design benefits people of color and women and the potential impact of proposed reforms on these communities.

Social Security’s Success

Social Security has been one of the country’s most successful social programs. It is largely responsible for the dramatic reduction in poverty among elderly people. Half of the population aged 65 and older would be poor if not for Social Security and other government programs. Social Security alone lifted over 11 million seniors out of poverty in 1997, reducing the elderly poverty rate from about 48 percent to about 12 percent. Additionally, Social Security has become more effective in reducing poverty over time. In 1970, Social Security reduced the poverty rate among the elderly from about 50 percent to 17 percent, compared to 12 percent today.

Social Security payments provide the majority of the income of poor and near-poor elders. In 1997, it was the major source of income for 66 percent of beneficiaries age 65 or older and it contributed 90 percent or more of income for about 33 percent of these individuals.

The Importance of Social Security to People of Color and Women

Social Security is particularly important to people of color. Elderly African Americans and Hispanic Americans rely on Social Security benefits more than white elders rely on the program. In 1997, Social Security benefits made up 43 percent of the income received by elderly African Americans and their spouses and 41 percent of income received by elderly Hispanic Americans, compared to 36 percent of the income of elderly whites. This is not surprising given the lower rates of pension coverage for people of color. Pension income was received by only one third of elderly African American and their spouses and one fourth of elderly Hispanic Americans. By comparison, 44 percent of elderly whites and their spouses received pension income. Moreover, people of color are disproportionately represented among low-wage workers. It is, therefore, more difficult to set aside savings for retirement to supplement Social Security.

Social Security is also an important source of income for women. The program made up 61 percent of total income received by elderly women in 1997 and it was the only source of income for one out of five elderly women. Compared to men, women have few resources other than Social Security to draw upon in their older years. Women have lower rates of pension coverage and pension
income than men. Only 30 percent of women 65 and older had pension coverage in 1994, while 48 percent of men were covered. Of those who began to receive benefits from private sector pensions in 1993-1994, the median annual benefit for women ($4,800) was only half of the amount received by men ($9,600). Additionally, women have lower labor participation rates and lower wages than men; as a result women are more likely to be poor. Women make up the majority of those whom Social Security lifts from poverty. In 1997, three of every five elderly people lifted out of poverty by Social Security were women.

While Social Security is intended to be one leg of a “three-legged stool” for retirement income, the lack of pension coverage and limited resources for savings place greater weight on Social Security as a reliable, guaranteed source of income for many people of color and women.

Social Security’s Protections for African Americans

The argument has been made that Social Security provides a lower rate of return to African Americans because this community has a lower life expectancy than the general population. Based on this premise, an African American worker would contribute payroll taxes, but would not live long enough to receive Social Security benefits sufficient to achieve the same rate of return as non-African American beneficiaries. This reasoning is faulty, however, as it overlooks important protections Social Security provides for African-American and low-wage workers including disability and survivors insurance.

The design of the Social Security system helps to compensate African Americans for their shorter life expectancy. There are three aspects of the program that provide such protection. First, Social Security’s benefit formula is progressive. Benefits replace a larger percentage of pre-retirement earnings for low-wage workers than high-wage workers. Since African Americans are disproportionately represented among low-wage earners, they gain from this formula.

The second feature is the option for early retirement. The Social Security system allows workers either to retire with full benefits at a given age, currently 65, or to retire early with reduced benefits. A worker can take early retirement at age 62. Workers who retire at 62 contribute payroll taxes for three fewer years. They also begin receiving benefits three years earlier, with monthly benefits reduced to compensate for the increased number of years during which they will receive benefits.

The reduction in the monthly benefit amount for those who retire early is based on actuarial tables and is intended to make the amount of benefits received from age 62 to the point of death equivalent, on average, to the amount of benefits retirees would receive if they waited until the “normal retirement age” to retire. Over the population as a whole, the Social Security early retirement option is close to a wash — the lower monthly benefits paid are designed to offset the increased number of years for which benefits will be received.
The story is different, however, for African Americans. Given the shorter life span for African Americans, the benefits these early retirees receive from age 62 to the end of their lives exceed the benefits they would receive, as a group, if they waited until 65 to retire. Starting to receive benefits several years earlier increases the total benefits they receive and raises their average rate of return. Two-thirds of all workers, including African Americans, retire early. Thus, most African-American retirees are partially compensated for their shorter life span by this aspect of Social Security.

The third component of Social Security that mitigates the impact of higher mortality among African Americans is the comprehensive nature of the program. Social Security is not solely a retirement program, but also an insurance system that protects against risks that are unforeseen or for which workers are not sufficiently prepared. In addition to benefits for retired workers, Social Security provides benefits to the worker’s spouse and dependents when the worker retires or becomes disabled, as well as survivors’ benefits if the worker dies. The divorced spouse of the retired or deceased worker also is generally entitled to benefits.

African Americans benefit disproportionately from the disability and survivors components of Social Security. While African Americans account for 11 percent of the civilian labor force, they comprise 18 percent of the workers receiving Social Security disability benefits in 1996. When a worker becomes disabled, the worker’s dependents also become eligible for Social Security benefits. African Americans made up 23 percent of children and 15 percent of the spouses who received Social Security benefits in 1996 because workers in their families were disabled.

As a result of the above-average mortality rates among African Americans, the African-American community benefits disproportionately from the feature of Social Security that provides benefits to non-elderly survivors. Although African-American children comprise about 16 percent of all children in the United States, they made up 24 percent of the children receiving survivors benefits in 1996. African Americans also accounted for 21 percent of the spouses with children who received survivors benefits. Benefits for non-aged survivors are one of the aspects of Social Security most favorable to African-American workers.

Some studies have attempted to estimate Social Security’s rate of return for African Americans. The Social Security Administration’s (SSA) Office of the Chief Actuary has assessed some of these estimates, such as those used by The Heritage Foundation, as well as the methodology for reaching the estimates. The actuaries found that the methodology was inaccurate and the estimates were wrong. Robert Myers, a former Chief Actuary of SSA, also has sharply criticized Heritage’s estimates as fundamentally flawed and invalid.

Most of these studies faced a major limitation. They did not have access to the one database on actual earnings records of workers and actual benefits of retirees, the Social Security Administration’s Continuous Work History database. This information is confidential and is not released to the public so that the privacy of workers and beneficiaries will be protected. These data
have been available only to Treasury and SSA researchers. One study that had access to these data was conducted by employees of the Treasury Department (Duggan, Gillingham, and Greenlees). These researchers found that African Americans had a slightly higher rate of return from Social Security retirees and survivors benefits than the general population. A second study by the Social Security Administration also used this database and looked specifically at disability insurance. It shows that African Americans received substantially more benefits from Social Security Disability Insurance in relation to the taxes they have paid than whites do. Thus, despite the shorter life span of African Americans, aspects of the program such as the progressive benefit, early retirement and comprehensive insurance offset the effects of higher mortality rates for this community.

**Social Security’s Protections for Hispanic Americans**

Hispanic Americans benefit doubly from Social Security. First, Hispanic retirees live longer, on average, than other Americans. The average American who reaches 65 (including both men and women) will live an additional 17.5 years, while the average Hispanic reaching 65 lives an additional 20.5 years. Those with a longer life span receive more monthly benefit checks from Social Security. Furthermore, Social Security’s annual cost-of-living adjustment — a feature most private annuities do not have — is of greater value for those who live longer. Social Security provides benefits that keep pace with inflation and cannot run out no matter how long one lives.

Hispanic Americans also gain from Social Security’s progressive benefit formula, which ensures that individuals who earned lower wages and/or had fewer years in the workforce receive larger monthly benefit amounts, in proportion to the wages they earned and the taxes they paid, than other workers do. Since Hispanic retirees on average have lower wages and fewer covered years of employment and also live longer than other workers, they receive benefit levels that return the taxes they paid in fewer years than average retirees do, while also receiving benefits for more years than the average retiree.

Hispanics consequently are one of the groups for which Social Security is most beneficial. A recent Social Security Administration fact sheet notes that Hispanic American beneficiaries “on average receive a higher rate of return on taxes paid.” A recent analysis by the Deputy Chief Actuary of the Social Security Administration explains that “a somewhat higher rate of return for Hispanic Americans is to be expected, based on the higher life expectancy for Hispanic Americans, and the fact that Hispanic Americans have lower than average earnings.”

**Social Security’s Protections for Women**

Several factors within the Social Security benefit structure help to compensate for the lower earnings of women. The benefit formula helps in two ways. First, the benefit formula is made
progressive by providing low-wage workers with a substantially higher percentage of their pre-retirement earnings than higher-wage workers. This aspect of the formula favors women, since their wages are lower than men’s wages. In fact, Social Security replaces 54 percent of the average lifetime earnings for the median female retiree and 41 percent of the earnings of the median male retiree. The second way in which the benefit formula helps women is through the determination of the worker’s average wage over his or her work life. This average wage is a critical part of the benefit formula. The average wage is the amount of earnings to which the progressive formula is applied. In determining the average, five of the lowest years of a worker’s earnings (including years with no earnings) are eliminated from the 40 years of earnings history that are reviewed. Since women are more likely than men to have dropped out of the labor force or to have worked part time, the elimination of the five lowest years helps to raise the average earnings figure used to compute their Social Security benefits.

In addition to the progressive benefit formula, Social Security provides other compensation to married women. A married woman can receive either a benefit based on her own earnings history or a spouse benefit equal to 50 percent of her husband’s benefit, whichever is larger. Although the number of women in the workforce has grown tremendously since the 1960s, some 63 percent of women beneficiaries 65 and older receive benefits based on their husbands’ earnings records. Given the longer life span for women, they also benefit greatly from the survivors insurance component of Social Security. An elderly woman who outlives her husband can receive a survivors benefit that is based on her own earnings history or she can receive 100 percent of her deceased husband’s benefit, whichever is larger. Approximately 74 percent of elderly widows receive benefits based on their deceased husbands’ earnings. A woman is eligible for spouse and survivors benefits even if she is divorced, as long as she was married for ten years and did not remarry before age 62.

Finally, the annual cost-of-living adjustment particularly benefits women due to their longer life span. Without this annual increase in benefits, the buying power of elderly women would decline substantially as they grow older.

As a result of these protections, women receive a higher rate of return from Social Security than men. Data from the Social Security Administration indicate that women pay 38 percent of the payroll taxes, but they receive 53 percent of the benefits.

The Need for Reform

Although the Social Security system has clearly served as an important source of income for the general population, including African Americans, demographic changes necessitate reforms in the program to maintain solvency. The baby-boom generation is aging and will begin retiring in large numbers after 2010. By 2025, most of this group will be 65 or older.
Moreover, rising life expectancy will further increase the number and proportion of the population that is elderly. The Social Security actuaries’ projections, reported by the Social Security trustees, show the number of people age 65 and older will nearly double from 34 million in 1995 to 61 million in 2025. During that period, the proportion of the total population that is elderly will grow from 12.5 percent to 18.2 percent. There also will be a decline in the rate of growth of the working-age population. As a result of these various changes, the ratio of workers to Social Security beneficiaries will decrease from just over three-to-one today to two-to-one in 2030, and remain at approximately this level through 2075, the last year of the actuaries’ projections. At that point, the elderly will comprise 22.7 percent of the total population.

Social Security payroll tax revenues currently exceed benefit payments and the trust funds are accumulating assets. The demographic changes that lie ahead, however, will result in substantial increases in benefit payments in coming decades and create an actuarial imbalance in the program over the long-term. The actuaries project that the assets in the trust funds will be exhausted by 2034. After 2034, the trust funds will be dependent entirely on payroll tax collections for income. From that time on, Social Security will be insolvent because it will not have sufficient annual income to make the full benefit payments to which its beneficiaries are entitled by law. This does not mean Social Security will collapse at that time and have no funds to pay any benefits; to the contrary, the problem is that after 2034, incoming payroll taxes are projected to be sufficient to cover about 70 percent of the benefit payments, rather than 100 percent of these costs. Policymakers need to make policy changes that eliminate this shortfall.

**Drawbacks of Some Individual Account Proposals**

Some proposals to reform Social Security would be particularly disadvantageous to people of color and women. Proposals to fully or partially privatize Social Security by diverting payroll taxes from the Social Security trust funds to individual accounts would have a detrimental impact on low-wage workers, people of color, and women.

How is it possible for advocates of individual accounts that replace Social Security benefits to claim that their proposals will benefit people of color, women and low-wage workers? The answer is proponents of these accounts often fail to factor in the costs and risk of such individual accounts when determining the rate of return for the accounts. There are three such types of costs — transition costs, the administrative costs and the cost to convert accounts to annuities.

If retirement benefits are privatized, the payroll taxes that are currently used to finance Social Security retirement benefits will instead be deposited in individual accounts. That will create a financing gap — funds will be needed to fulfill the government’s obligation to pay Social Security benefits to current retirees and those nearing retirement. Robert Reischauer, a senior fellow at the Brookings Institution, addressed this point in his statement at the White House Forum on Social Security in New
Mexico, July 27, 1998. “Whether we retain the existing system or privatize it, this unfunded liability will have to be met unless we renego on the benefits promised to today’s elderly and near elderly. Dealing with the unfunded liability inescapably will reduce the returns workers can expect on their contributions.”

Under a privatized system that divers all payroll taxes into individual accounts, workers would have to pay a new tax to continue financing the Social Security benefits of current and soon-to-be retirees. As senior researcher Paul Yakoboski of the Employee Benefit Research Institute has testified, “Because the current Social Security system is largely pay-as-you-go, most of what workers pay into the system funds today’s benefits. . . . [O]n top of paying current benefits, workers moving to a privatized system would have to pay ‘twice’ — for the benefits going to today’s beneficiaries and again to their own [personal] accounts.”

A study conducted by the Employee Benefit Research Institute incorporated transition costs into its calculations. It found that for workers who are 21 today and receive low wages, the rate of return would be lower under the individual accounts options it examined than under all options it examined to restore long-term balance to Social Security without individual accounts.

Administrative costs further reduce the rate of return for individual accounts. Accounts that are designed like IRA accounts will result in significant administrative costs and management fees, which would be paid out of the proceeds of the accounts and consequently reduce the amounts available in those accounts to pay retirement benefits. Moreover, additional costs are incurred when the funds in these accounts are converted to lifetime annuities upon retirement.

Based on data on IRA accounts, two eminent Social Security experts — Henry Aaron of the Brookings Institution and Peter Diamond of M.I.T. — have estimated that the administrative costs for retirement accounts like IRAs would consume 20 percent of the amounts that otherwise would be available in these accounts to pay retirement benefits. They note that a one percent annual charge on funds in such accounts eats up, over a 40-year work career, 20 percent of the funds in the accounts. The 1994-1996 Advisory Council on Social Security estimated an annual charge of one percent on the assets in privately managed individual accounts.

Furthermore, recent financial data indicate that a one percent annual charge is a conservative estimate. In 1997, the average annual charge on stock mutual funds was 1.49 percent of the amounts invested in those funds. In addition, Diamond has noted that administrative and management costs consume approximately 20 percent of the amounts in individual accounts in Chile’s privatized retirement system. Research by Mamta Murthi, J. Michael Orszag and Peter R. Orszag showed that the combination of these fees and annuitization costs eat up an average of 43 percent of the funds in privatized retirement accounts in Great Britain.
Some of these costs are fixed-dollar expenses that do not vary with the size of an account. As a result, such costs would generally consume a larger percentage of the amounts in smaller-than-average accounts (and a smaller percentage of the amounts in large accounts). This suggests these costs would, on average, consume more than 20 percent of the funds in the accounts of lower-wage workers. That is of particular significance to African Americans since, as a group, they receive lower-than-average wages and would consequently have smaller-than-average accounts.

To these costs must be added the costs of converting an individual account to an annuity upon retirement. The leading research on this matter indicates that an additional 15 percent to 20 percent of the value of an individual account is consumed by the costs that private firms charge for converting accounts to annuities. The General Accounting Office recently noted that “While individual annuities are available, they can be costly especially relative to annuities provided through Social Security.”

Taking all of these costs into account — both administrative and management fees and the costs of converting accounts to annuities — Aaron estimates that at least 30 percent and as much as 50 percent of the amounts amassed in individual accounts similar to IRAs would be consumed by these costs rather than being available to provide retirement income. (While the administrative cost would be lower for centrally managed accounts similar to the federal employees Thrift Savings Plan, the cost would still be significantly higher than the administrative cost for Social Security.)

In addition to the costs of these individual accounts, there are some risks. Retirees who are particularly lucky or wise in their investments could receive retirement income from individual accounts that more than offsets their loss of Social Security benefits. But retirees who are less lucky or wise, including those who retire and convert their account to a lifetime annuity in a year the stock market is down, would likely face large reductions in the income they have to live on in their declining years.

A recent GAO report takes note of these issues. “There is a much greater risk for significant deterioration of an individual’s ‘nest egg’ under a system of individual accounts,” the GAO wrote. “Not only would individuals bear the risk that market returns would fall overall but also that their own investments would perform poorly even if the market, as a whole, did well.

This is a concern for workers in general — surveys have found Americans are not very knowledgeable about financial markets — and a particular concern for lower-wage workers, who generally would not be able to afford as good investment advice as individuals at higher income levels. Moreover, lower-income groups have less investment experience and would be more likely to invest in an overly conservative manner because they could not afford to expose the funds in their accounts to much risk. African Americans, Hispanic Americans and women make up disproportionate shares of the low-income population. As a result, they would be likely to receive a somewhat lower-than-average return on amounts invested even while, as explained above, they would likely pay an above-average percentage of their holdings in fees.
Shortcomings of the Archer-Shaw Plan

Representatives Bill Archer and Clay Shaw recently introduced a Social Security reform plan with individual accounts that attempts to address several of the limitations previously noted. Under their plan, long-term solvency would be restored, beneficiaries would be guaranteed to receive the benefit levels to which current law entitles them, and Social Security taxes would not be increased. However, there remain several shortcomings that have important consequences for people of color and women.

The Archer-Shaw plan makes large transfers of general revenue to Social Security that could place too great a strain on the rest of the budget for much of the next half century. If most or all of the non-Social Security surplus is consumed by tax cuts, as the Congressional budget resolution envisions (or by a combination of tax cuts and upward adjustments in discretionary spending levels, as could result from negotiations between Congress and the Administration), there would be only one place from which the plan’s individual accounts could initially be funded — the Social Security surpluses. This evidently is what the plan’s sponsors have in mind.

After about 2012, however, the plan’s costs would exceed the Social Security surplus. For several decades after that, financing the individual accounts the plan would establish would result in substantial problems for the rest of the budget and likely lead to large cuts in other programs, increases in taxes, or budget deficits.

The cost of the plan would be substantial in these years. The plan’s costs include not only the cost of depositing funds into the individual accounts but also the cost of higher interest payments on the federal debt. (Higher interest payments would have to be made because large sums would have been deposited in the individual accounts rather than used to pay down the debt.) According to the Social Security actuaries, the net costs of the Archer-Shaw plan — the costs of the deposits into individual accounts and the higher interest payments on the debt, minus the savings the plan would produce in Social Security costs — would run from $300 billion to $600 billion a year each year from 2016 through 2042.

With the Social Security surpluses no longer able to cover such costs — and with little, if any, surplus likely to remain in the non-Social Security budget in these years because the baby boomers will be retiring in large numbers and costs for health care programs and some other expenditures will be mounting accordingly — financing the individual accounts is likely to entail substantial tax increases or program cuts if policymakers seek to avoid sizeable deficits.

Some of the programs that would be cut are likely to be programs that benefit people of color and women. Thus, while their Social Security benefits are guaranteed, other programs of importance to their lives could be reduced.
The plan also raises equity concerns. *The only group of retirees who could receive an increase in government-funded retirement benefits under the plan would be upper-income workers.* Yet a broad array of Americans, including many of average or modest means, might have to absorb cuts in other benefits or services or tax increases to help finance the individual accounts after 2012.

Finally, there is a high degree of risk that the plan would lead over time to a substantial weakening of support for Social Security. This is one of the plan’s most significant weaknesses — over time, it could undermine the system it seeks to save. Under the plan, many middle- and upper-middle-income workers would receive only a modest Social Security benefit, which would equal the difference between the annuity payment from their individual account and the Social Security benefit level to which they are entitled. Social Security would appear to provide little in return for the 12.4 percent of wages these workers and their employers pay into the Social Security system. As a result, higher-wage workers may become less supportive of Social Security while low-wage workers remain reliant on the program. The universal support that the program now enjoys would be placed at risk.

Moreover, the plan could invite misleading comparisons. Many retirees would likely compare the annuity benefit their individual account would provide — which would have been financed with annual deposits equal to two percent of their wages — to their Social Security benefit, financed with 12.4 percent of their wages. They could conclude Social Security was a bad deal and the law should be changed to shift large sums from Social Security to individual accounts. As a number of leading Social Security analysts have written, however, such a comparison would be highly misleading: it would ignore the fact that Social Security payroll taxes must finance benefits to previous generations of workers, pay for disability and survivors insurance, and finance the provision of more adequate benefits to low-wage workers and to spouses who spent years out of the labor force raising children, among others. If the same amount of additional funding were provided directly to the Social Security trust funds and allowed to be invested in a similarly diversified manner, the Social Security trust funds would secure a higher rate of return than the Archer-Shaw individual accounts, since the administrative costs of establishing and maintaining 150 million individual accounts would be avoided.

**An Alternative Approach**

President Clinton has proposed an alternative plan to reform Social Security and several aspects of the plan could be beneficial to people of color and women. In his 1999 State of the Union address, President Clinton proposed to transfer 62 percent of the unified budget surplus to the Social Security trust funds. These funds would be used to pay down the debt held by the public.

The President’s plan would also invest 15 percent of the trust funds in the equities. These investments would be overseen by a new independent institution outside the executive branch that would be designed to be insulated from political pressures. The equity investments would be limited to passive
investments in broad index funds. Investing a portion of the trust funds in equities markets would enable Social Security to earn higher rates of return and meet its long-term obligations without having to reduce benefits or raise taxes as much as would otherwise be necessary.

If a goal of Social Security reform is to raise the rate of return to Social Security, it is not necessary to create individual accounts to achieve this goal. Increased rates of return are not the result of individual accounts; they are the result of advanced funding (that is, setting aside the funds needed to pay Social Security benefits in advance). By investing the trust funds in equities, advanced funding can be achieved without the transition costs or administrative costs of individual accounts.

By contrast, the Archer-Shaw plan is structured in a way that renders it inefficient. The plan would transfer general revenues to individual accounts that would be managed by Wall Street brokerage firms and other private fund managers and enable these firms to take substantial sums out of the accounts in commissions and management fees, only to have nearly all of the proceeds from these individual accounts then transferred back to the Social Security trust funds to help pay Social Security benefits. Based on the actuaries’ assumptions regarding these costs, the administrative and management costs that would be paid on these accounts would total approximately $350 billion over the system’s first 30 years, equaling $34 billion a year by 2030 and larger amounts in years after that. It makes little sense to incur costs of this magnitude.

A third component of the President’s plan is to commit 12 percent of the unified budget surplus to the creation of USA accounts. The President’s plan would preserve the guaranteed benefit that is the cornerstone of the Social Security system and would not divert any revenue from the trust funds. Furthermore, the USA accounts are designed to be progressive in several ways. They are targeted to low- and middle-income earners and their spouses. The government would contribute the same amount of money ($300) to each worker’s account. This means the contribution will represent a higher percentage of income for low-wage earners than for high wage earners. And under this proposal, the government would also provide progressive matching contributions to workers who add their own savings to their accounts or to a 401(k)-type employer-sponsored plan. Low- and moderate-income workers would receive a dollar-for-dollar match. This government match would be phased down to 50 cents for higher-income workers until the income eligibility ends.

Not only do these accounts primarily benefit low- and moderate-income workers, they incorporate the spouse protection feature of Social Security that would benefit women. Spouses, both current and divorced, are eligible for USA accounts even if they do not work outside the home.

This proposal would not alter the basic structure of the Social Security system that has played such a vital role in the economic well-being of people of color and women. At the same time, it would encourage savings using a design that targets resources to workers who would benefit the most from an increase in their retirement income.