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## AFRICAN AMERICANS AND SOCIAL SECURITY: THE IMPLICATIONS OF REFORM PROPOSALS

By William Spriggs and Jason Furman<sup>1</sup>

Social Security is a critical program for African Americans. Some 4.8 million African Americans currently receive Social Security benefits, and African Americans benefit disproportionately from many of Social Security's features, including a progressive benefit structure and survivors and disability benefits. Proposals to scale back the traditional Social Security system and replace a portion of it with private accounts are unlikely to maintain these protections for African Americans to the same degree. As a result, such a shift is likely to have an adverse effect on the African American community.

This analysis first examines how the current Social Security system affects African Americans. It then analyzes the impact that some private accounts proposals would have on them.

The analysis is not intended to imply that nothing should be done to reform Social Security. To the contrary, the fact that the program is so important for African Americans reinforces the need to ensure that it remains solvent. The analysis concludes, however, that making Social Security solvent should not come at the expense of key beneficial features of the current system. It should be done instead through balanced reforms that preserve the existing social insurance system.

### KEY FINDINGS

- Studies show African Americans receive modestly more in Social Security benefits for each dollar they pay in payroll taxes than whites do.
- African Americans earn 73 percent as much as whites, on average, but because of Social Security's progressive benefit structure, their average retirement benefit is about 85 percent as much as whites'.
- African Americans benefit disproportionately from Social Security's disability and survivors benefits, since they are more likely than other workers to become disabled or die before retiring. For example, while 15 percent of all U.S. children are African American, 23 percent of the children receiving Social Security survivors benefits are.
- 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.

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## The Importance of Social Security to the African American Community

Half of the 4.8 million African Americans who receive Social Security benefits today are retired workers. The other half are disabled workers or the spouses or children of disabled, retired, or deceased workers. Some 800,000 African American Social Security beneficiaries are children under 18; almost 1 in every 19 African American children receives a monthly Social Security check.<sup>2</sup> The average age of African American beneficiaries is 58. Social Security is important to African Americans of all ages.

There are several key reasons that Social Security is of disproportionate importance to African Americans:

- Social Security has a progressive benefit structure. Since African Americans have lower lifetime earnings than whites, on average, they benefit disproportionately from this aspect of Social Security. Other features of Social Security provide additional protections for African Americans.
- Social Security's family income insurance is comprehensive; it provides insurance against becoming disabled and pays survivors benefits to the families of deceased workers. African Americans are more likely than other Americans to benefit from these insurance components of Social Security.

Indeed, studies have consistently found that African Americans get a modestly *higher* rate of return on their Social Security contributions than do whites.

Social Security also makes up a larger share of the income of elderly African Americans than of elderly white people. This reflects, in part, the fact that African Americans are less likely to have retirement accounts or life insurance than whites. Elderly African Americans also have a harder time finding work and have less in earnings than do elderly whites. These factors make Social Security an even more important component of African Americans' retirement security.

### The Progressive Benefit Structure

Social Security uses a progressive formula to calculate benefits for retirees, survivors, and disabled workers. Take people who retired in 2003, as an example. People who retired that year and had average earnings over their careers of no more than \$606 a month receive monthly Social Security benefits equal to *90 percent* of their average monthly pre-retirement earnings. In other words, Social Security benefits are replacing 90 percent of their earnings. By contrast, for very high-income individuals, Social Security benefits replace about 25 percent of average pre-retirement earnings.

African Americans have significantly lower average lifetime earnings than non-minorities and consequently receive Social Security benefits that replace a larger share of their pre-retirement incomes than non-minorities do. This can be seen in two statistics. The earnings of African Americans workers equal 73 percent of white workers' earnings, on average. But the average

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<sup>2</sup> Chad Newman, "Demographic and Economic Characteristics of Children in Families Receiving Social Security," Social Security Bulletin, Vol. 65 (August 2004), Table 2.

monthly Social Security retirement benefit for African Americans equals about 85 percent of the average benefit for white retirees.

Other features of the Social Security benefit formula also protect African Americans. For example, the Social Security benefit formula is based on the highest 35 years of earnings; it discards other years. This helps African Americans, since they have double the unemployment rates and also experience longer average spells of unemployment than whites do. African-American men consequently have a higher number of years with no earnings than whites do, on average. By ignoring some years of no or low earnings in calculating benefits (since only the highest 35 years of earnings are counted), the Social Security system benefits African Americans. A study published in the *Social Security Bulletin* confirmed this, finding that counting additional years of earnings toward benefits would harm African Americans disproportionately.<sup>3</sup>

These progressive features of Social Security are partially offset by the fact that African Americans have lower life expectancies and thus are likely to collect Social Security retirement benefits for fewer years, on average, than whites. Studies discussed in more detail below have confirmed, however, that the progressive features of Social Security that benefit African Americans more than outweigh the life-expectancy effect.

#### Disability and Survivors Benefits

Social Security is a social insurance program. It insures American workers and their spouses and children against the loss of income if a worker is unable to engage in regular, full-time work because of disability, death or old age. Although much discussion focuses on Social Security retirement benefits, Social Security disability and survivors benefits are important and substantial. In July 2005, they accounted for 30 percent of all Social Security benefit payments.<sup>4</sup>

Moreover, the Social Security actuaries have estimated that disability benefits are worth \$350,000 to a representative family. In other words, if a worker who earns average wages and has a spouse and two young children becomes permanently disabled, the disability benefits that Social Security will pay to the family over the years that family members receive these benefits will total approximately \$350,000.<sup>5</sup>

American men in their 20s face a 3-in-10 chance of becoming disabled before reaching full retirement age. Social Security disability insurance thus is very important to U.S. workers. But for African American men, the incidence of disability is even higher. This is reflected in Social Security statistics. African Americans constitute 11.5 percent of all workers who are covered by Social Security, but they make up 17.6 percent of Social Security disability beneficiaries.

African Americans also have a disproportionately high chance of dying before reaching retirement age. While two of every 10 white men in their 20's will die before reaching retirement age, four in

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<sup>3</sup> Steven H. Sandell, Howard M. Iams, and Daniel Fanaras, "The Distributional Effects of Changing the Averaging Period and Minimum Benefit Provisions," *Social Security Bulletin* 62(2), 1999.

<sup>4</sup> Social Security Administration, "OASDI Monthly Statistics," July 2005.

<sup>5</sup> This total is expressed in present value. That is, the amount of money up front that, with interest, would equal the total Social Security disability payments.

ten African American men in their 20s will meet this fate.<sup>6</sup> 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.<sup>7</sup>

And survivors benefits can be very substantial. The Social Security actuaries have estimated that if a worker earning average wages dies and leaves behind a spouse and two young children, Social Security will provide the family with survivors benefits worth \$403,000.<sup>8</sup> The survivors benefits that Social Security will pay such a family over the years are the equivalent of the family's receiving a \$403,000 inheritance.

### African Americans Have Less Wealth and a Harder Time Finding Work

Social Security's universal coverage helps to fill the gap in retirement savings between African Americans and whites. The Federal Reserve Board's Survey of Consumer Finance shows that while 43 percent of white households have retirement savings accounts (IRAs or 401(k)s), only 18 percent of African American and Hispanic households do. Similarly, while 40 percent of white households have life insurance, just 22 percent of African American and Hispanic households do.<sup>9</sup> Furthermore, researchers Christian Weller and Edward Wolff have found that whites nearing retirement age have almost *three times* more in pension and retirement savings on average than African Americans and Hispanics.<sup>10</sup>

In contrast, the gap in Social Security benefits are much smaller. Expected Social Security benefits can be expressed as "Social Security wealth," which is the amount of money, with interest, that would equal the Social Security benefit payments. The white-black gap in Social Security wealth is 1.8 to 1, considerably smaller than the gap in other forms of wealth.

In addition, because of Social Security, the black-white income gap is smaller for the elderly than for any other age group. While African Americans aged 45 to 49 have incomes that average 60 percent of those of their white counterparts, African Americans 65 and over have incomes that average 69 percent of their white counterparts.<sup>11</sup>

### Studies Consistently Show African Americans Get a Higher Rate of Return

Because of the features of Social Security that are particularly beneficial to African Americans, a wide range of studies from official government agencies and leading academic researchers has

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<sup>6</sup> Elizabeth Arias, "United States Life Tables, 2002," *National Vital Statistics Reports*, Vol. 53 (November 10, 2004), [http://www.cdc.gov/nchs/data/nvsr/nvsr53/nvsr53\\_06.pdf](http://www.cdc.gov/nchs/data/nvsr/nvsr53/nvsr53_06.pdf), Tables 5 and 8.

<sup>7</sup> Data from the Bureau of the Census and "OASDI Monthly Statistics," July 2005.

<sup>8</sup> Office of the Chief Actuary, "Present Values of Expected Survivor and Disability Benefits for an Illustrative Case," July 23, 2001.

<sup>9</sup> The retirement accounts exclude defined benefit accounts, and the life insurance numbers exclude term life plans. <http://www.federalreserve.gov/pubs/oss/oss2/2001/bulltables.xls> Table 5.

<sup>10</sup> Christian Weller and Edward Wolff, *Retirement Income: The Crucial Role of Social Security* (Washington, DC: Economic Policy Institute, 2005): [http://www.epinet.org/books/retirement\\_income/retirement\\_income-full.pdf](http://www.epinet.org/books/retirement_income/retirement_income-full.pdf) Table 12.

<sup>11</sup> For whites: [http://pubdb3.census.gov/macro/032004/hhinc/new02\\_004.htm](http://pubdb3.census.gov/macro/032004/hhinc/new02_004.htm) and [http://pubdb3.census.gov/macro/032004/hhinc/new02\\_005.htm](http://pubdb3.census.gov/macro/032004/hhinc/new02_005.htm) for African Americans.

consistently produced the same finding — African Americans get modestly higher rates of return from Social Security than do non-Hispanic whites. In other words, they receive a little more back for each dollar paid in payroll taxes than whites do.

These studies are based on large data sets that capture the differences in experience between different groups of people, including differences in earnings, mortality, and other demographic characteristics. A number of these studies are based on an actual historical sample of Social Security earnings and/or benefits. Other studies use a historical sample to develop a projection of future incomes and benefits.

The Social Security program itself is race blind. The benefits it pays are a function of a worker's earnings history and family situation. The findings of these studies reflect the fact that the Social Security system is progressive (i.e., of greater benefit, relative to taxes paid, for people with lower incomes, even after taking into account the fact that people with lower incomes tend to have higher mortality rates).

We provide here a summary of the leading studies that have been conducted on rates of return in Social Security by race. These studies take into account differences in earnings, mortality rates, disability rates, and other factors.

The studies fall into three categories: those that examine Social Security retirement and survivors benefits but do not include disability benefits; studies that examine rates of return on disability benefits; and studies that cover the entire Social Security system (i.e., retirement, survivors *and* disability benefits).

**1. Studies Examining Social Security Retirement and Survivors Benefits.** These studies have consistently found that African Americans have a similar or slightly higher rate of return than whites in the retirement and survivors portions of Social Security. (The precise results can be sensitive to the cohort examined and the measure of redistribution used.)

- Study conducted by Treasury economists: A major study conducted by economists from the Department of the Treasury, using the Social Security Administration's Continuous Work History Sample (a sample of nearly 40,000 actual earnings histories), found that African-Americans received an average annual rate of return half a percentage point higher than the average rate of return for whites (where the "white" category generally includes both Hispanic and non-Hispanic whites).<sup>12</sup> This is a relatively large difference when compounded over several decades to retirement, potentially translating to thousands of dollars at retirement.
- Social Security Administration study: Dean Leimer of the Social Security Administration used an even more comprehensive data set and confirmed the earlier findings. Leimer reported that "the results generally support the findings of closely related previous research, confirming

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<sup>12</sup> James E. Duggan, Robert Gillingham, and John S. Greenlees, "Returns Paid to Early Social Security Cohorts," *Contemporary Policy Issues* 11(4), October 1993. The study is based on the Social Security Administration's pre-1980 classification of race into three categories: white, black, and other/unknown. According to Dean Leimer of the Social Security Administration, "most persons of Hispanic origin appear to be coded as White under the old SSA race code." See Dean R. Leimer, "Historical Redistribution Under the Social Security Old-Age and Survivors Insurance and Disability Insurance Programs," Office of Research, Evaluation and Statistics Working Paper Number 102, Social Security Administration, February 2004.

that... the 'Other Races' group fared better by these measures than the 'White' race group in most of the cohorts considered." Leimer found that males of "other races" received a 0.4 percent higher annual rate of return, on average, than white males, and females of other races received a 0.7 percent higher average rate of return than white females.<sup>13</sup> (Note that the "white" category generally includes both Hispanic and non-Hispanic whites. Other studies have shown that Hispanics, as a group, consistently have a higher Social Security rate of return than either African Americans or non-Hispanic whites.<sup>14</sup> Thus Leimer's results are likely to *understate* the difference between non-Hispanic whites and blacks.)

- **Liebman study:** Jeffrey Liebman, an economist at Harvard's Kennedy School of Government whose work on Social Security is widely cited, simulated rates of return for future years, using data on past differences in incomes, mortality, and other demographic characteristics derived from data from the Survey of Income and Program Participation (SIPP) and the Social Security Administration's historical records. His study found that African Americans will receive an average annual rate of return from Social Security that is 1.64 percent above the inflation rate, slightly above the 1.52 percent real average rate of return for non-Hispanic whites.<sup>15</sup>
- **Urban Institute/Social Security Administration study:** Analysts from the Urban Institute and the Social Security Administration conducted an analysis using the MINT model (Modeling Income in the Near Term), a large micro-data set that projects incomes through 2031 and is the main model that the Social Security Administration uses for its analyses on a range of Social Security issues. The analysts found that for people born between 1956 and 1965 (the group examined in this study), African American men will receive an average annual rate of return that is 1.99 percent above the inflation rate, as compared to 1.96 percent above inflation for non-Hispanic white men. For women, the difference was slightly larger: a 3.33 percent average annual rate of return (above inflation) for African-American women, compared to a 3.20 percent average rate of return for non-Hispanic white women.<sup>16</sup> An earlier and more comprehensive study by the same authors found that for some earlier birth cohorts, whites had a higher rate of return than blacks.<sup>17</sup>

**2. Studies of Social Security Disability Insurance.** Studies that have examined rates of return by race in the Social Security disability insurance program have found larger differences between the races in this part of Social Security. Here, as well, African Americans receive higher rates of return than whites.

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<sup>13</sup> Dean R. Leimer, "Historical Redistribution Under the Social Security Old-Age and Survivors Insurance Program," Office of Research, Evaluation and Statistics Working Paper Number 101, Social Security Administration, April 2003.

<sup>14</sup> See also Fernando Torres-Gil, Robert Greenstein, and David Kamin, "The Importance of Social Security to the Hispanic Community," *Center on Budget and Policy Priorities*, June 28, 2005.

<sup>15</sup> Jeffrey Liebman, "Redistribution in the Current U.S. Social Security System," in Martin Feldstein and Jeffrey B. Liebman (eds.) *The Distributional Aspects of Social Security and Social Security Reform*, Chicago: University of Chicago Press, 2002. Note, Liebman's results are for the cohort born from 1925-1929.

<sup>16</sup> C. Eugene Steuerle, Adam Carasso, and Lee Cohen, "How Progressive is Social Security and Why?" *Straight Talk on Social Security and Retirement Policy*, No. 37, May 2004.

<sup>17</sup> C. Eugene Steuerle, Adam Carasso, and Lee Cohen, "Social Security Redistribution by Education, Race, and Income: How Much and Why," Boston College Retirement Research Center, May 2001.

- Urban Institute/Social Security Administration study. The Urban Institute-SSA study referred to above 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.<sup>18</sup>
- Social Security Administration study. Dean Leimer of the Social Security Administration conducted a separate study on disability insurance. This study did not analyze rates of return but compared the amount of money contributed in payroll taxes to disability insurance to the amount of benefits received from 1957 through 1995. Leimer found that for every \$1 contributed to the DI program from 1957 to 1995, whites got \$0.88 back while “other races” got back \$1.30. (Note, these results do not establish that disability insurance is a “bad deal” for whites. Leimer makes no attempt to project future Social Security benefits. Some of the contributions to payroll taxes in the 1957 to 1995 period will go toward future disability benefits that were not captured in Leimer’s window.)<sup>19</sup>

**3. The Entire Social Security Program.** Several studies have examined returns by race for the Social Security program as a whole. (Note: most of these studies exclude benefits for children. Including such benefits would likely increase the degree to which African Americans receive a higher average rate of return than whites, because a larger share of African American children than of white children receive Social Security benefits.)

- Government Accountability Office Study. The GAO conducted a study of minorities and Social Security, using the MINT model. As the GAO explained in its summary of the study: “In the aggregate, blacks and Hispanics have higher disability rates and lower lifetime earnings, and thus as a group tend to receive greater benefits relative to taxes than whites.” Specifically, the GAO study finds that non-Hispanic blacks get nearly 10 percent more in benefits for every tax dollar contributed to Social Security than do non-Hispanic whites.<sup>20</sup>
- Social Security Administration study. Dean Leimer updated his earlier studies to include the entire Social Security program. The more comprehensive study found: “The generally more modest favorable treatment to date on average of ‘Other Races’ relative to ‘Whites’ in most of these cohort groups under the OASI program [i.e., Old Age and Survivors insurance, the technical term for the parts of Social Security that provide retirement and survivors benefits] is reinforced by the generally substantial relative advantage of ‘Other Races’ within each birth cohort under the DI [Disability Insurance] program.”<sup>21</sup> In other words, minorities received higher-average returns than non-minorities.

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<sup>18</sup> C. Eugene Steuerle, Adam Carasso, and Lee Cohen, “How Progressive is Social Security When Old Age and Disability Insurance Are Treated as a Whole?” *Straight Talk on Social Security and Retirement Policy*, No. 38, May 2004.

<sup>19</sup> Dean R. Leimer, “Historical Redistribution Under the Social Security Disability Insurance Program,” Office of Research, Evaluation and Statistics Working Paper Number 77, Social Security Administration, July 1998.

<sup>20</sup> GAO, “Social Security and Minorities,” GAO-03-387, April 2003.

<sup>21</sup> Dean R. Leimer, “Historical Redistribution Under the Social Security Old-Age and Survivors Insurance and Disability Insurance Programs,” Office of Research, Evaluation and Statistics Working Paper Number 102, Social Security Administration, February 2004. Leimer cautioned that these results “still exhibit some sensitivity to the choice of redistributive measure and interest rate series.”

## Flawed Heritage Foundation Study on African Americans and Social Security

A 1998 Heritage Foundation report that is often cited by proponents of private accounts claims that Social Security is a bad deal for African Americans — and gives them a lower rate of return than whites receive — because African American men have shorter life expectancies than white men.\* President Bush echoed this claim earlier this year when he commented that “African American males die sooner than other males do, which means the system is inherently unfair to a certain group of people.”\*\*

The Heritage report has been subject to careful scrutiny, however, and has been thoroughly discredited. The study has been severely criticized by, among others, Stephen Goss, the Chief Actuary of the Social Security Administration, and Robert Myers, the former Chief Actuary of the Social Security Administration, who for decades was the leading advisor on Social Security to Congressional Republicans and served as Executive Director of the 1983 Greenspan Commission.

For example, in a detailed analysis of the Heritage report, Goss (who was the Deputy Chief Actuary at the time) found that “the [Heritage] conclusions are highly misleading due to two major errors in methodology, plus a number of incorrect or inappropriate assumptions.... In fact, results from more careful research reflecting actual work histories for workers by race indicate that the non-white population actually enjoys the same or better expected rates of return from Social Security than for the white population.” †

Goss demonstrated that Heritage’s “approach consistently overstates the expected number of years of work and consistently underestimates the expected rates of return from Social Security retirement benefits. Moreover, the extent of this bias is greater for workers with lower life expectancy, in particular African Americans.”

Goss found that a 20-year-old African American man would be expected to receive Social Security retirement benefits for nearly *four times* as many years as Heritage assumed. His analysis showed that the number of years for which 20-year-old African American men are expected to receive Social Security retirement years is equal to 20.7 percent of their work years but that Heritage erroneously assumed that the number of benefit years for these men would equal 4.9 percent of their work years. Goss reported that “while this is the largest and most fundamental error in the Heritage analysis, a number of additional errors further bias the results.”

Robert Myers’ critique of the Heritage report, published in *The Actuary* magazine, was, if anything, even more scathing. Myers described the Heritage results as “grossly in error due to faulty methodology” and as being marred by a “fatal flaw.” ‡ (For more details on the defects in the Heritage study, see Kilolo Kijakazi, “African Americans, Hispanic Americans, and Social Security: the Shortcomings of the Heritage Foundation Reports,” Center on Budget and Policy Priorities, October 8, 1998.)

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\*William W. Beach and Gareth G. Davis, “Social Security’s Rate of Return,” Heritage Foundation, January 15, 1998.

\*\*White House, “President Participates in a Conversation on Social Security Reform,” January 11, 2005.

† Stephen C. Goss, Social Security Administration, “Problems with ‘Social Security’s Rate of Return,’ A Report of the Heritage Center for Data Analysis,” January 27, 1998.

‡ Robert Meyers, “A Glaring Error: Why One Study of Social Security Misstates Returns,” *The Actuary*, September 1998.

- Urban Institute/Social Security Administration study. The Urban Institute-SSA study found consistently higher rates of return under the overall Social Security program for African-Americans than for whites, with these differences in rates of return being larger than those



found in the Leimer study.<sup>22</sup> The analysts who conducted this study projected rates of return for the cohorts born from 1956-64. Their results show that non-Hispanic black males receive an average rate of return of 2.4 percent per year, compared to 1.9 percent for non-Hispanic white males. The gap for women is similar, with a 3.6 percent average annual rate of return for non-Hispanic black women, compared to a 3.0 percent average annual return for non-Hispanic white women.

## The Impact of Private Accounts Proposals on the African American Community

Private accounts do not contain the features that make Social Security such an effective program for African Americans, such as a progressive benefit formula, disability benefits, and survivors benefits. As a result, reducing traditional Social Security benefits and replacing them with private accounts would tend to make the system less favorable for African Americans. The GAO took note of this basic point in its study on Social Security and minorities, where it warned that “reforms that [restore solvency] by tying benefits more directly to contributions [as private accounts do] may affect the progressivity of the system and are likely to disproportionately affect equity for minorities.”<sup>23</sup>

### Private Accounts and African Americans

Private accounts carry risk. Robert Shiller, a Yale economist and noted financial expert (and author of *Irrational Exuberance*), examined the President’s original private-accounts proposal. Under that proposal, under the President’s proposal as subsequently modified, and under most other leading private-accounts plans, 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. The repayments would be collected by being subtracted from the worker’s monthly Social Security retirement benefits. Under the President’s original proposal, if the investments a worker made with the funds in his or her private account earned, on average, more than 3 percent per year above the inflation rate (more than about 5.8 percent overall, since inflation is projected to average about 2.8 percent in the future), the worker would come out ahead. In such cases, the amount that would accumulate in the account would exceed the amounts subtracted from the worker’s Social Security benefits. If, however, the investments made with the funds in a worker’s account earned *less* than 3 percent above the inflation rate on average (or less than about 5.8 percent overall), the worker would come out behind — the worker would lose more in Social Security benefit reductions, as a result of having elected a private account, than he or she would get from the account itself.

Professor Shiller found that under such an arrangement, between one-third and two-thirds of workers who opted for a private account would lose money on the deal.<sup>24</sup> They would be worse off financially as a result of having elected a private account. (The Administration later modified its proposal so that private accounts would have to yield average annual earnings more than 2.7 percent above the inflation rate — or more than about 5.5 percent overall — for a worker to come out

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<sup>22</sup> C. Eugene Steuerle, Adam Carasso, and Lee Cohen, “How Progressive is Social Security When Old Age and Disability Insurance Are Treated as a Whole?” *Straight Talk on Social Security and Retirement Policy*, No. 38, May 2004.

<sup>23</sup> GAO, “Social Security and Minorities,” GAO-03-387, April 2003.

<sup>24</sup> Robert Shiller, “Life Cycle Portfolios as Government Policy,” *Economist’s Voice* Volume 2:1, <http://www.bepress.com/ev/vol2/iss1/art14>.

ahead. Shiller's analyses suggest that a substantial portion of workers would continue to lose money under this approach.)

Moreover, the risks would be more acute for African Americans than for whites, and the potential rewards likely would be smaller. Some of the elements that make the current Social Security system work for African Americans would tend to be weakened if part of Social Security were replaced by private accounts, while certain disadvantages that African Americans face in the labor market as compared to whites would be magnified under private accounts. These disadvantages include gaps in earnings at younger ages and lower average pay than whites who have the same level of education.

- For example, the timing of the employment gap between whites and African Americans would work against African Americans under a system of private accounts. It is more difficult for young African Americans than young whites to gain a foothold in the labor market. In 2004, some 55.7 percent of African Americans aged 20-24 were employed, compared to 71 percent of whites. By age 30-34, this gap shrinks: 75.5 percent of African Americans are employed at that age, compared to 80.1 percent of whites. The result is that a higher share of whites would be contributing to a private account at younger ages, when their savings would have *more years to grow* because of the compounding of interest over a longer period.<sup>25</sup> Under Social Security, by contrast, earnings in earlier years are *not* more important than earnings in later years.
- In addition, the large gaps in earnings between whites and African Americans with the same level of education mean that African Americans must spend more time out of the labor market getting more education to earn as much as less-educated whites. For instance, white male high school graduates with no further educational degrees average \$38,340 a year in earnings. This is a level of income that African Americans with an associates degree do not reach (\$32,010 a year).<sup>26</sup> Years out of the labor market are years when contributions to private accounts cannot be made.
- Another factor relates to economic growth cycles. Economist Christian Weller has shown that periods when the labor market is booming — which are the periods when African Americans increase their employment rates relative to whites — tend to be periods when the stock market is higher and it consequently costs more to buy stocks. This suggests that if Social Security is partially replaced with private accounts, African Americans will, to a greater degree than whites,

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<sup>25</sup> Note: most private-accounts proposals include both an individual account and a requirement that a worker who elects a private account have his or her Social Security benefits reduced in return. Under many of these proposals, including the President's current proposal and the plans proposed by Senator DeMint and Rep. McCrery, the offsetting benefit reductions would not be large enough to repay Social Security in full for the amounts diverted to private accounts. The Social Security system would effectively be *subsidizing* the private accounts.

The size of the subsidies would depend on the amounts contributed to a private account — the larger the contributions, the greater the subsidy would be. This means that the government subsidies would be larger, at least in terms of absolute dollars, for higher-income workers than for lower-paid workers, and hence would be greater on average for whites than for African Americans.

Moreover, the subsidies would worsen Social Security solvency. Because of the subsidies, the Social Security system would suffer a loss on private accounts and be driven deeper into the red. These losses ultimately would have to be covered through deeper reductions in Social Security benefits or larger increases in taxes.

<sup>26</sup> For whites: [http://pubdb3.census.gov/macro/032004/perinc/new03\\_130.htm](http://pubdb3.census.gov/macro/032004/perinc/new03_130.htm) and for African Americans [http://pubdb3.census.gov/macro/032004/perinc/new03\\_005.htm](http://pubdb3.census.gov/macro/032004/perinc/new03_005.htm).

tend to make stock-market purchases with funds placed in their private accounts *at times when the market already is high* and stocks cost more, rather than buying into the market when stock prices are lower. Making a larger share of stock purchases when the market is high would tend to lower the rate of return that African American workers' portfolios would secure, relative to the portfolios of white workers.

Finally, establishing private accounts would do nothing to address Social Security's financing shortfall. Private accounts, by themselves (i.e., without the transfer of large sums from the rest of the budget), would *increase* costs for the Social Security system for a number of decades and thereby hasten the date when the system is projected to become insolvent.<sup>27</sup>

### The President's Plan

The President's Social Security plan would alter the Social Security benefit formula by instituting what the White House refers to as a "sliding-scale benefit formula" and some analysts refer to as shifting from "wage indexing" to "progressive price indexing." This means that 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.

Under this proposal, all workers with average annual earnings of more than \$20,000 (in today's terms) would see their Social Security benefits reduced compared to what they would receive under the current benefit structure. Workers who earned average wages and retired at age 65 in 2045 would receive benefits that were 16 percent lower than currently scheduled benefits. Average-wage earners who retired in 2075 would receive benefits 28 percent lower than the currently scheduled benefits.<sup>28</sup>

Based on the current earnings of African American workers, the effects of the President's sliding-scale benefit reductions would be to reduce the Social Security retirement benefits of African-American workers who are aged 26 to 31 today by an average of 10.5 percent. Benefits of those who are 32-41 today would be reduced by 7.2 percent, and the benefits of those aged 42 to 54 today would be reduced by 2.8 percent.<sup>29</sup>

These percentage reductions are modestly smaller than the average benefit reductions that white workers would face, because whites earn more than African Americans on average, and the percentage benefit reduction under the President's proposal would rise as earnings increased (until earnings reached \$90,000 in today's terms). Yet although the average benefit reductions would be somewhat smaller for African-Americans than for whites, they could be more difficult for African Americans to absorb. While the average percentage cut in Social Security benefits would be smaller

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<sup>27</sup> Most private-account proposals assume large transfers from the rest of the budget, despite the fact that the rest of the budget is projected to be in deficit as far as the eye can see and to have no surplus revenue to transfer.

<sup>28</sup> For more details, see Jason Furman, "An Analysis of Using 'Progressive Price Indexing' to Set Social Security Benefits," *Center on Budget and Policy Priorities*, May 2, 2005.

<sup>29</sup> See William E. Spriggs and David Ratner, "Social Security price indexing proposal means benefit cuts for workers," *Economic Policy Institute*, Issue Brief #209 at: <http://www.epi.org/content.cfm/ib209>

for African-Americans than for whites, these benefit cuts would represent a *larger* percentage reduction in African Americans' *overall retirement income*, because Social Security makes up a much bigger share of retirement income for African Americans than for whites.<sup>30</sup> (Social Security accounts for 82 percent of the income of elderly African-American couples whose income is at the median income level for elderly households — and 84 percent of the income of elderly Hispanic households at this income level — but only 66 percent of the income of non-Hispanic white elderly households at this level)<sup>31</sup>

Furthermore, the President's proposal would apply the same sliding-scale benefit reductions to survivor benefits that it would apply to retirement benefits. Adopting these benefit reductions would reduce the benefits for the survivors of a worker who is age 25 today, dies at age 55 in 2035, and leaves behind a spouse and three qualifying children by \$4,641 a year, or 13.8 percent. Given that African American children are more likely to receive Social Security survivors benefits than white children and that a smaller share of African Americans than whites have private life insurance, such cuts in survivors benefits could prove especially problematic for the African American community.<sup>32</sup>

### Other Social Security Proposals

Certain other Social Security proposals also would adversely affect African Americans, either directly or indirectly. Among the leading Social Security proposals in Congress are bills introduced in the summer of 2005 by Senator Jim DeMint and Rep. Jim McCrery (S. 1302 and H.R. 3304). Under these two proposals, which are similar to each other but not identical, private accounts would be limited in size, and contributions would be made to accounts only through 2016. (Contributions would be made only as long as Social Security's annual tax revenues exceeded its annual benefit payments.) No changes to Social Security benefits or revenues would be made to improve Social Security's finances, and Social Security solvency would not be restored.<sup>33</sup>

These 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 and to have no surplus revenue to transfer. In the absence of this budget gimmick — that is, without the assumed transfer of large sums from the rest of the budget — these proposals would *worsen* Social Security's finances and accelerate the date when Social Security would become insolvent. Those proposals also would result in substantial increases in the national debt.

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<sup>30</sup> See William E. Spriggs and David Ratner, "Social Security price indexing proposal means benefit cuts for workers," Economic Policy Institute, Issue Brief #209 at: <http://www.epi.org/content.cfm/ib209>

<sup>31</sup> See Michael Ettlinger and Jeff Chapman, "Social Security and the income of the elderly," Economic Policy Institute, Issue Brief #206 at: <http://www.epinet.org/issuebriefs/206/ib206.pdf>, Table 1.

<sup>32</sup> See William E. Spriggs and David Ratner, "Social Security's cruelest cut," Economic Policy Institute, Issue Brief #211 at: <http://www.epi.org/content.cfm/ib211>

<sup>33</sup> See Jason Furman and Robert Greenstein, "The DeMint and McCrery Social Security Plans," *Center on Budget and Policy Priorities*, July 20, 2005.

Proponents of these plans have said they intend for the plans to serve as a foot in the door to larger, permanent private accounts. Paying for larger accounts on an ongoing basis, however, would require additional Social Security benefit reductions or payroll tax increases.

A final, but important, point is that virtually all of the proposals that have been offered to replace part of Social Security with private accounts have the potential to weaken support for the Social Security system over time. These proposals are designed in a way that would make private accounts misleadingly appear to be more favorable than standard Social Security benefits. Under most private-account proposals, workers who elected private accounts would have their Social Security benefits reduced in return, in order to repay Social Security for the funds that had been diverted from it to the private accounts. If large private accounts were established, Social Security benefits would have to be reduced to very low levels in future decades for millions of middle- and upper-income retirees. That, in turn, could (and almost certainly would) be used to portray the traditional Social Security system as a bad deal to millions of Americans, who would have paid substantial Social Security payroll taxes over their careers but would appear to be getting little in return since they would receive only small Social Security benefits. (Most of their benefits would have been cancelled in order to pay for their private accounts.) This could lay the groundwork for efforts to sell the public on proposals to replace most or all of what remained of Social Security with even larger private accounts, an approach that would have decidedly negative consequences for African Americans.

Potentially an even more important political risk lies in the de-linking of Social Security retirement, survivor's and disability benefits that would occur under most private-account plans. Under current Social Security law, all three components of Social Security are integrated seamlessly and share the same benefit structure. For example, a worker who is transitioning from Social Security disability benefits to Social Security retirement benefits (as occurs automatically when a disabled worker reaches retirement age) experiences no change in his or her Social Security benefits. (The only change is in federal accounting, with the benefit payments starting to be recorded as retirement benefit payments instead of disability benefit payments.) By contrast, virtually all private-account plans would sever the current link between the benefit structures for Social Security disability and survivors benefits and the benefit structure for retirement benefits. These plans initially would provide more protection for disability, and in some cases, survivors' benefits. Over the longer run, however, this de-linking of the disability and survivors insurance components of the program from the retirement component would result in major technical and substantive complications. For example, 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 when he or she reached retirement age. Ultimately, this could drive a wedge between different Social Security constituencies and undercut support for the basic structure of the disability and survivors insurance components of the program.

## Conclusion

The current Social Security system is highly beneficial for African Americans. This has two implications. First, Social Security should not be radically restructured or partially replaced with a system that does not have the key features of the current system that substantially benefit African Americans.

Second, current projections show that 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 on Social Security more in old age than do other groups. Hence, reforms to restore long-term Social Security solvency are essential.

A sensible reform approach that restores solvency in a balanced manner while protecting and preserving the current Social Security system is the course that would serve the African American community best.