Unnecessary Risk:

The Perils of Privatizing Social Security

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Report by the U.S. Congress Joint Economic Committee
Representative Carolyn B. Maloney, Chair

Introduction

For 75 years, millions of American workers have relied on the Social Security program as a foundation for their retirement security. Social Security benefits, which are based on a worker's lifetime earnings, are one of three important sources of economic well-being for retired workers, along with employer-provided retirement plans and private savings. In recent years, retirement plans have moved away from offering a specified level of retirement income (so-called "defined benefit plans"), moving instead to a system based on employee and employer contributions ("defined contribution plans"). This shift has meant that fewer workers have a guaranteed level of income in retirement from employer plans, which along with the recent volatility in asset markets, has elevated Social Security's role in retirement security for many Americans. In addition, Social Security continues to protect workers and their families against a devastating loss of income in the event of unforeseen disability or death.

Nearly 53.7 million Americans – nearly 1 in 6 – receive Social Security payments.[1] While the majority of those beneficiaries are retirees, over 30 percent of Social Security beneficiaries receive either survivors insurance or disability insurance payments.

Social Security benefits are a substantial source of income for older Americans. Even the wealthiest retirees depend on Social Security benefits for one-quarter of their retirement income. Social Security benefits are also a driving factor in reducing poverty among retirees. Nearly half (46 percent) of Americans 65 and older would be living below the poverty line without Social Security income; the benefits provided by Social Security reduce the poverty rate to one-in-ten. For lower-wage and middle-income earners who are less likely to have jobs with employer-sponsored retirement plans or significant private savings, Social Security plays a vital role in reducing poverty later in life, providing nearly 80 percent of income for the least well-off aged 65 or older.

In recent months, Republicans have revived two significant changes to the Social Security program first put forward by President Bush in 2005: "privatization" and "progressive price indexing." H.R. 4529, The Roadmap for America's Future Act of 2010, introduced by Congressman Paul Ryan, incorporates both changes. The first proposal is to privatize the program by allowing future retirees to divert a portion of their payroll taxes to individual investment accounts. The second proposal is to change the formula for calculating initial benefits, characterized as "progressive price indexing" by its proponents. While the proposals claim to address future shortfalls in the Social Security Trust Fund, as the analysis below makes clear, private accounts would weaken the solvency of the Social Security Trust Fund and its ability to be a cornerstone for economic security for retirees while "progressive price indexing" would result in deep cuts in future benefits, which would have disproportionate impacts on middle-income workers. Combined, these proposals would erode the economic security and peace of mind that Social Security provides to millions of Americans.

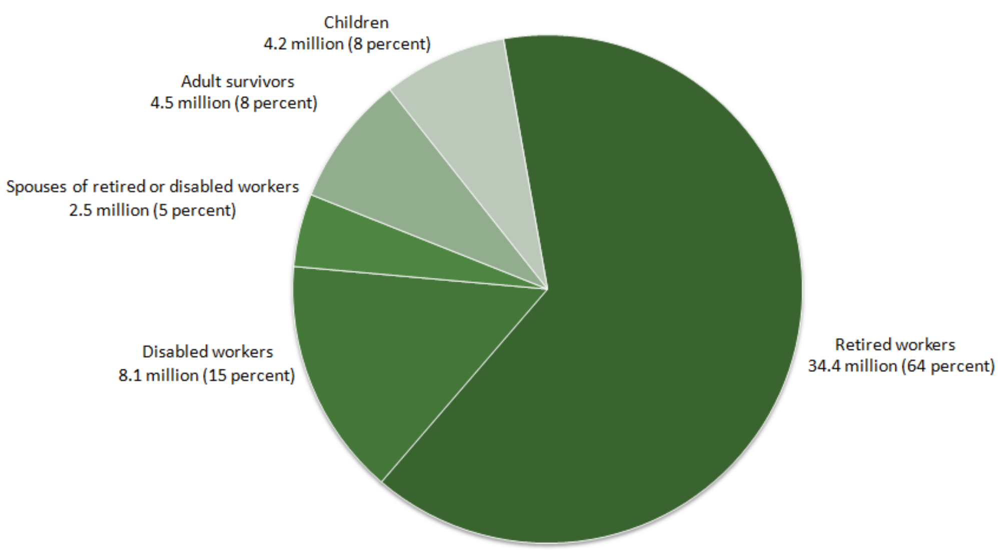
Americans Depend on Social Security

Social Security Benefits Americans across Demographic Groups

Nearly 53.7 million Americans receive Social Security benefits as a retired or disabled worker, or as the spouse or child of a retired, disabled or deceased worker. Most Social Security beneficiaries (64 percent) are retired workers (34.4 million) or their family members (2.9 million); however, a significant number of people receive benefits through the disability insurance program (10.0 million) and the survivors insurance program (6.3 million).[2]

As shown in **Figure 1**, Social Security provides benefits not only to retired and disabled workers, but also to the family members of workers who die, retire or become disabled. In addition to the 4.2 million children who receive benefits, 6.9 million adults receive benefits as a spouse or survivor. The vast majority (6.8 million) of those are women. In fact, over half of adult female Social Security beneficiaries receive benefits as the family member of a retired or disabled worker.[3]

Figure 1. 53.7 Million Americans Receive Social Security Benefits
Social Security Recipients by Type of Beneficiary



Note: Children includes children of retired workers, disabled workers, and children survivors of deceased workers.
Source: Joint Economic Committee Majority Staff calculations based on data from the Social Security Administration, Monthly Statistical Snapshot," September 2010.

Among all recipients, benefits paid out in 2009 equaled $675.8 billion, or 83.7 percent of total trust fund revenues.[4] The average benefit was $1,064 per month, or $12,768 annually. According to the Census Bureau, Social Security benefits kept 20.5 million people out of poverty in 2009, including 1.1 million children under 18 and 14.0 million adults aged 65 years or older.[5]

Social Security is a Substantial Source of Income for Older Americans

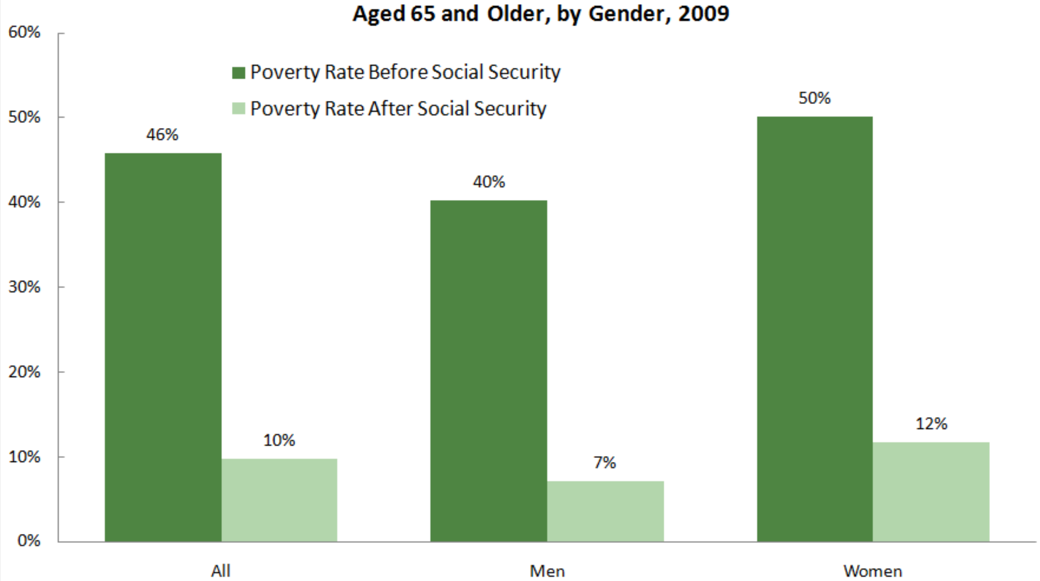
Social Security benefits, while modest, are by far the most common major source of income for Americans aged 65 or older. In 2008, 87 percent of elderly households received income from Social Security.[6] Income from private savings was the second most common source of income for persons 65 years or older, with 54 percent of households drawing income from assets. In 2008, more elderly households relied on Social Security for a portion of their income than relied on private pensions (28 percent) or government employee pensions (14 percent).

Older Americans' reliance on Social Security income for economic security is even more apparent when viewed as a share of their total incomes. In 2008, 64 percent of elderly households received at least half of their income from Social Security and 34 percent received more than 90 percent of their income from Social Security.[7]

More importantly, Social Security benefits are a driving factor in reducing poverty among that population. As **Figure 2** shows, nearly half (46 percent) of Americans 65 and older would be living below the poverty line without Social Security income; the benefits provided by Social Security reduce the poverty rate to one-in-ten. For lower-wage and middle-income earners, who are less likely to have access to other retirement income such as an employer-sponsored retirement plans or private savings, Social Security plays a vital role in reducing poverty later in life, providing nearly 80 percent of income for the least well-off aged 65 or older. The reduction in the poverty rate is most dramatic among women, where half of women 65 years and older would be living in poverty but for Social Security.

Figure 2. Social Security Dramatically Reduces Poverty Among Older Americans

Poverty Rates Before and After Social Security for Persons Aged 65 and Older, by Gender, 2009



Source: Joint Economic Committee Majority Staff calculations based on data from the Current Population Survey, March 2010 Supplement.

Problems with Privatization and Progressive Price Indexing Proposals

Privatizing Social Security Subjects Retirement Security to Investment Risks

As outlined in the Republican legislation, The Roadmap for America's Future Act of 2010, workers under the age of 55 in 2014 would be able to divert a portion of their payroll taxes to individual, privately managed accounts in exchange for smaller guaranteed Social Security benefits. This would not only weaken the solvency of the Social Security Trust Fund and require large increases in federal borrowing, it also would undermine the fundamental goal of Social Security: to provide a foundation for economic security in retirement and in the event of unexpected income losses due to disability or death.

The current Social Security system provides a life-long inflation-indexed monthly payment (also called an annuity) for retirees and disabled workers, as well as their families. Even if retirees could convert their private accounts into an annuity at retirement, it is unlikely that they could purchase one that is indexed for inflation, as the current system provides. Further, private accounts may leave retirees open to fluctuations in the performance of the stock market or may encourage lower-income workers to borrow against retirement savings in order provide food and education for their children. In addition, allowing current contributors to channel funds out of the general Social Security fund into private accounts would exacerbate the shortfall in revenues for current retirees, as well as current and future recipients of disability or survivors insurance payments.

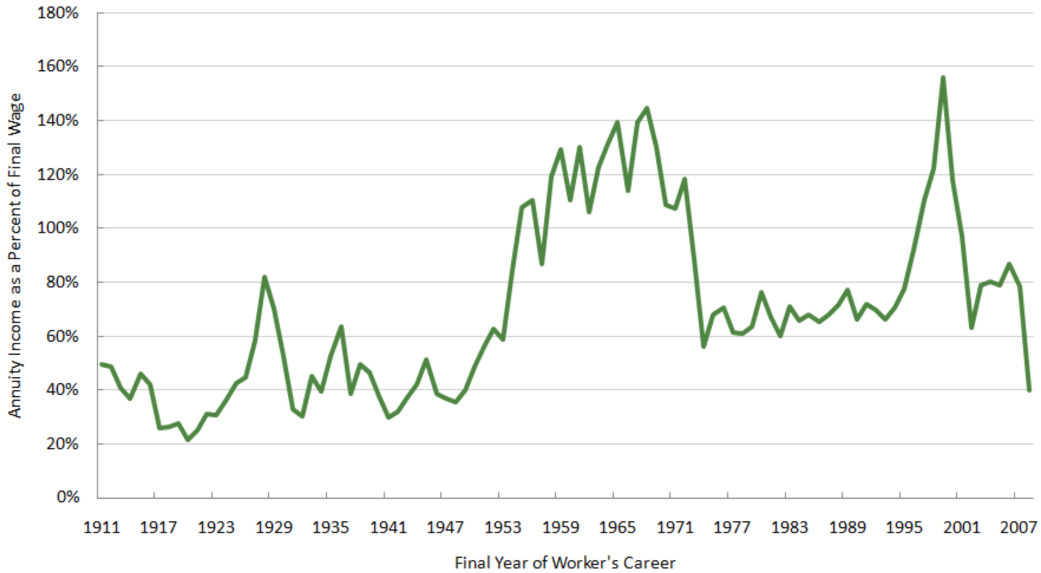
To receive a guaranteed level of income in retirement, a retiree would need to convert his or her retirement savings, including the balance of his private investment account, into an inflation-indexed annuity. However, unlike traditional Social Security benefits, which provide a guaranteed, predictable source of retirement income, the accumulations in private accounts would be subject to investment risks: account accumulations can vary substantially depending on overall market returns, individual investment decisions, and the prevailing interest rate at the time a worker purchases an annuity.

Wide fluctuations in returns from the stock market, bond market or other asset market, such as housing, would make it hard for even the most sophisticated investors to determine the best investment portfolio to realize a desired income level in retirement.[8] Even the savviest investor may have difficulty in making the correct allocations between different types of assets with different rates of return and riskiness, as well as anticipating stock market drops that could have a large impact on savings.

Figure 3 illustrates how susceptible retirement assets would be to fluctuations in the stock market. A worker who invested 7 percent of his earnings in the stock market over a 40-year career could have purchased an annuity upon retirement in 1999 that would have replaced 156 percent of his final salary. However, an annuity purchased by a worker with the same investment strategy who retired just three year later in 2002 would have replaced only 63 percent of his final year earnings. The Great Recession and the stock market collapse would have further eroded the value of the worker's retirement assets – an annuity purchased upon retirement in 2008 would provide a post-retirement income of only 40 percent of the worker's final income.[9]

Figure 3. Stock Market Fluctuations Would Lead to Significant Swings in Retirement Annuities

Replacement Rate Calculated Based on 7 Percent Contribution of Annual Salary in the S&P 500 Over a 40-year Career



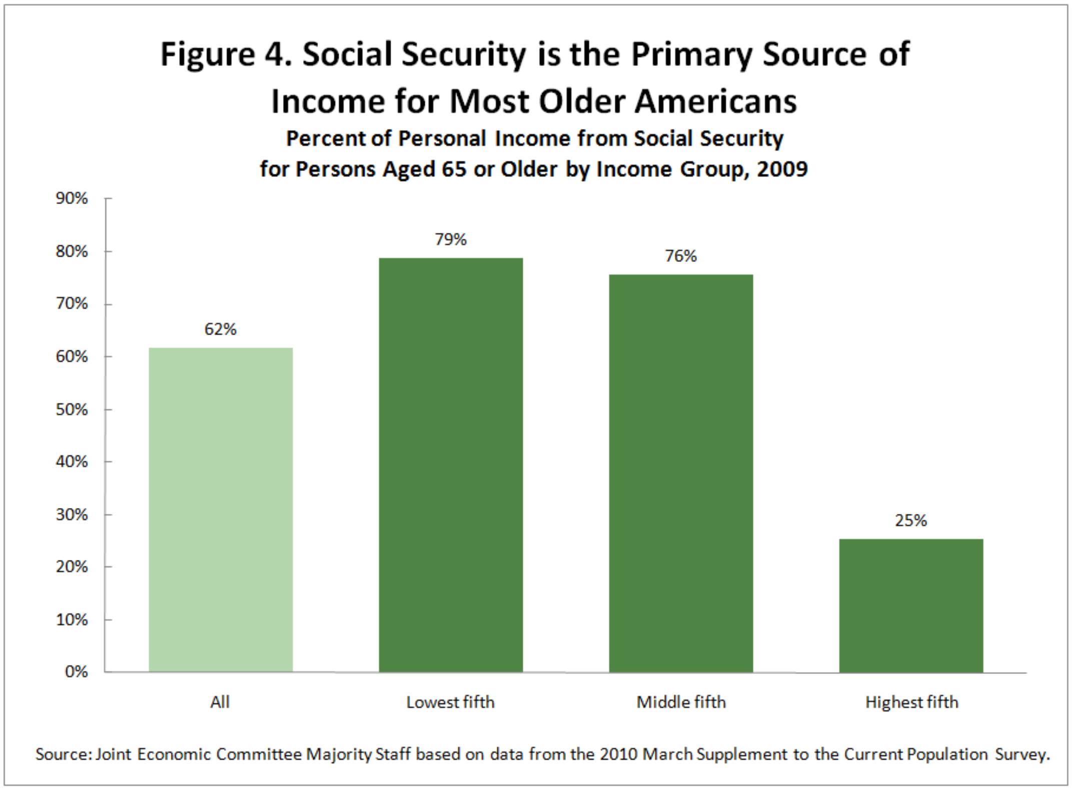
Source: Gary Burtless, Brookings Institution.

The pitfalls of privatization can be seen in countries, such as Italy, where workers were allowed to put a portion of their national pensions into privately invested accounts, only to find that these private accounts lost the bulk of their value after the global financial crisis. Italy's benchmark stock market index fell by 50 percent in 2008, destroying almost half a trillion dollars in wealth.[10]

Private Accounts Jeopardize Retirement Security of Vulnerable Populations

Social Security plays an important role for retirement security among older Americans, providing an estimated 62 percent of retirement income for individuals 65 years of age and older, as shown in **Figure 4**. Even among the most well-off, Social Security benefits provide one-quarter of their income. Thus, income fluctuations due to privatization could jeopardize the economic security of even the wealthiest retirees.

Social Security's current progressive benefit structure provides lower earners with a larger benefit relative to their average lifetime earnings than for higher earners. Eliminating the progressive benefit structure, as privatization would do, would further harm the economic well-being of groups that traditionally have lower earnings – women, Hispanics and African Americans.[11] Moreover, misinformation or a lack of access to sound investment advice might unnecessarily jeopardize the retirement security of segments of the population most reliant on Social Security benefits. For the least well-off retirees, Social Security provides 79 percent of income. (**See Figure 4.**)



Social Security is especially important to the most vulnerable women, providing 81 percent of women's income in the lowest income group.[12] There is no guarantee that under a privatization plan workers would be required to provide benefits to their spouse (or surviving spouse) or any former spouses, or that any benefit that would be available would be comparable to what is available under current law. Consequently, the economic security of millions of women would be further threatened with private accounts because women are more likely than men to receive spousal or survivor benefits.

Federal Investments to Encourage Retirement Saving Mostly Benefit Higher-Income Workers

The U.S. government currently encourages workers to save for retirement through tax incentives for investing in Individual Retirement Accounts (IRAs) and contributing to employer-sponsored retirement plans. Low-income households are less likely to utilize those two legs of the "3-legged retirement stool," and are therefore more dependent on Social Security for their retirement security. As shown in **Table 1**, federal tax expenditures (foregone federal tax revenues) from these retirement savings incentives totaled $110 billion in 2009. While most of the incentivized savings programs are available to workers at all income levels, the benefits overwhelmingly accrue to higher-income households who are three times as likely to have access to employer-provided retirement plans and overwhelmingly more likely to contribute to tax-incented retirement savings accounts. [A more detailed discussion of the value of federal tax expenditures for retirement saving follows in the Appendix.]

Table 1. Federal Tax Expenditures for Retirement
Fiscal Year 2009 (billions of dollars)

Item	Amount
Employer contributions to pension plans	40.7
401(k) plans	44.1
Individual Retirement Accounts	12.1
Low and moderate income savers credit	1.1
Keogh plans	12.8
Total	**110.8**

Source: JEC Calculations Based on Data from Office of Management and Budget, 2010. Appendix, Budget of the United States Government, Fiscal Year 2011, Table 16-1.

Privatizing Social Security Ignores Value of Disability and Survivor Benefits

Earnings taxed for Social Security do not only pay for a guaranteed retirement benefit, but they also pay for disability insurance and survivors insurance. Calculating the value of such insurance policies in the private market has traditionally been hard to do because unlike most policies available, disability and survivor benefits protect against inflation. These benefits would be severely diluted if payroll taxes were diverted from the Social Security Trust Funds.

Progressive Price Indexing Erodes Link between Social Security's Contributions and Benefits

Plans to reform Social Security, like President Bush's 2005 proposal and H.R. 4529, would cut guaranteed benefits for all but the lowest earners by changing from wage-indexing to price-indexing benefits. Currently, benefits are computed based on a worker's wage history, adjusted for overall growth in average annual wages. Progressive-price indexing would adjust middle-income earners' wage histories based on a mix of changes in prices and wages, and would adjust higher-income earners' wage histories based on changes in prices, eroding the current relationship between workers' contributions to Social Security and the benefits received in retirement income. Because prices typically grow slower than wages, this change would result in steep reductions for middle-income retirees, and even steeper reductions for retirees with higher earnings.[13]

Although benefit cuts would be smaller for middle-income retirees, progressive price indexing would undoubtedly have a larger impact on the economic well-being of middle-class retirees who depend on Social Security for more than three-fourths of their income, compared to high-income retirees who depend on Social Security for only one-quarter of their income, as shown in **Figure 4**.

Benefit cuts from progressive price indexing would grow deeper overtime. According to the Center on Budget and Policy Priorities, a new retiree in 2050 with average earnings would receive benefits 17 percent lower than under current law. By 2080, a new retiree with average earnings would receive a 28 percent reduction in defined benefits.[14] Since middle-income retirees depend on Social Security for 76 percent of their retirement income, a 28 percent reduction in benefits could reduce retirement income for middle-income retirees by 21 percent. For example, a worker who expected to receive $2,000 per month in retirement income in 2080 from all sources could count on a retirement income of only $1,574.

Conclusion

Social Security benefits, while modest, have played a valuable role in reducing poverty rates, especially among Americans over 65 years of age. Last year alone, it kept more than 20 million people out of poverty. The Republican proposals to change Social Security would erode the ability of Social Security to be a safety net for middle-class and lower-wage workers, especially as they age and become unable to participate in the labor force.

The Republicans have dusted off Social Security proposals that were rejected in 2005. They've attempted to cast their most recent proposals as modest adjustments or changes to the existing Social Security system, with only a portion of funds being diverted from the traditional system to private accounts. But the reality is that even diverting a small share of total revenues into private accounts for workers under the age of 55 will have a profound and harmful impact on the solvency of the Social Security Trust Fund and put at risk the fundamental goal of Social Security: providing economic security in retirement and in the event of unexpected income losses due to disability or death.

Appendix

The U.S. government encourages private saving for retirement by providing tax incentives for investing in Individual Retirement Accounts (IRAs) or contributing to an employer-sponsored retirement plan.

Table 1 shows revenue losses (also known as federal tax expenditures) due to either pre-tax contributions to retirement savings accounts or tax-deferred interest on contributions for fiscal year 2009.[15] Total tax revenue losses in fiscal year 2009 were over $100 billion, most of which was due to employers' contributions to retirement plans or employees' contributions to 401(k) plans.[16] Keogh plans are available to self-employed individuals who do not have access to a traditional employer-sponsored retirement plan. Although there are tax incentives only available to low- and moderate-income workers to save for retirement, these workers often struggle to make ends meet and are less likely to have supplemental income to save for retirement.[17] Consequently, the foregone tax revenue from this credit is remarkably lower than for other retirement saving incentives.

Table 1. Federal Tax Expenditures for Retirement Fiscal Year 2009 (billions of dollars)

Item	Amount
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Low and moderate income savers credit	1.1
Keogh plans	12.8
Total	**110.8**

Source: JEC Calculations Based on Data from Office of Management and Budget, 2010. Appendix, Budget of the United States Government, Fiscal Year 2011, Table 16-1.

With the exception of the savers' credit for low- and moderate-income individuals, all of these savings programs are used to defer taxes rather than avoid tax payments altogether. Therefore, a more accurate picture of the budgetary impact of these programs on the federal budget is shown in **Table 2**. **Table 2** is a calculation of the present discounted value of the revenue impacts, net of future tax payments, for these tax-deferred savings programs. As shown in Table 2, allowing tax-deferral for these retirement accounts cost the government $209 billion (in 2009 dollars).

Table 2. Present Discounted Value of Selected Tax Expenditures 2009 (billions of dollars)

Item	**Amount**
Employer contributions to pension plans	74.3
401(k) contributions	113.0
IRA contributions and earnings	4.0
Roth earnings and distributions	11.2
Non-deductible IRA earnings	0.5
Contributions and earnings for Keogh plans	6.3
Total	**209.3**

Source: JEC Calculations Based on Data from Office of Management and Budget, 2010. Appendix, Budget of the United States Government, Fiscal Year 2011, Table 16-4.

While workers of all income levels are permitted to tax advantage of the savings programs listed in **Table 2**, the tax benefits accrue disproportionately to higher-income workers. For example, a traditional IRA allows an individual taxpayer to contribute a certain amount of his or her pre-tax income, depending on taxpayer's income, tax filing status and coverage by an employer-sponsored retirement plan. However, cash-strapped families are less likely to be able to contribute to IRAs. As of 2007, only 1.2 percent of IRAs were owned by families with incomes under $20,000, and 22.4 percent of IRAs were owned by families with household incomes less than $75,000.[18] In contrast, families with household incomes of $150,000 or more owned half of all IRAs.[19]

Similarly, employees with an employer-sponsored retirement plan are also allowed to contribute to a retirement plan using pre-tax income. Nearly 70 percent of civilian employees have access to employer-provided retirement plans.[20] However, both the availability and participation levels in these plans are lower for lower-wage workers.[21] Less than one-third of workers with average wages in the bottom 10 percent have employer-provided retirement benefits and only 12 percent of workers with these wages participate in such a plan. In contrast, 90 percent of workers in the top 10 percent wage category have access to employer-provided retirement plans and 83 percent of these workers participate in such plans.[22]

[1] Social Security Administration, Office of Retirement and Disability Policy. *Monthly Statistical Snapshot*, September 2010, available on-line at http://www.ssa.gov/policy/docs/quickfacts/stat_snapshot/.
[2] Calculation based on data from the Social Security Administration, Annual Statistical Supplement, 2009, Table 5.A6.
[3] Calculation based on data from March 2010 Current Population Survey.
[4] Social Security Administration, Fast Facts & Figures About Social Security 2010, available on-line at http://www.ssa.gov/policy/docs/chartbooks/fast_facts/2010/fast_facts10.pdf
[5] Income, Poverty, and Health Insurance Coverage: 2009, PowerPoint from News Conference, U.S. Census, September 16, 2010, available on-line at http://www.census.gov/newsroom/releases/pdf/09-16-10_slides.pdf
[6] Social Security Administration, Fast Facts & Figures About Social Security 2010, available on-line at http://www.ssa.gov/policy/docs/chartbooks/fast_facts/2010/fast_facts10.pdf
[7] *Ibid.* See also JEC Majority Staff, Celebrating 75 Years of Social Security, August 2010, available on-line at http://jec.senate.gov/public/index.cfm?p=Reports1&ContentRecord_id=c12a3f88-57f4-4677-bf08-47164c78fb6d&ContentType_id=efc78dac-24b1-4196-a730-d48568b9a5d7&Group_id=c120e658-3d60-470b-a8a1-6d2d8fc30132
[8] Gary Burtless, "Lessons of the Financial Crisis for the Design of the National Pension Systems," *CESinfo Economic Studies*, 2010.
[9] See Gary Burtless.
[10] Andrew David and Alessandra Migliaccio, Italian Pensions Sapped by Private Funds Bush Backed," Bloomberg, January 5, 2009.
[11] See for example, Kathryn L. Moore, "Partial Privatization of Social Security: Assessing its Effect on Women, Minorities, and Lower-Income Workers." Missouri Law Review, 2000.
[12] Calculations based on data from March 2010 Current Population Survey.
[13] See Jason Furman, Center on Budget and Policy Priorities. *An Analysis of Using "Progressive Price Indexing" to Set Social Security Benefits*, Revised May 2, 2005; and Congressional Budget Office, *Social Security Policy Options*, July 2010.
[14] Paul N. Van de Water, Center on Budget and Policy Priorities. *Ryan Plan Makes Deep Cuts in Social Security*, October 20, 2010.
[15] See Office of Management and Budget, 2010. Federal Receipts, Supplemental Materials, Budget of the United States Government, Fiscal Year 2011 for further information, available on-line at http://www.whitehouse.gov/sites/default/files/omb/budget/fy2011/assets/receipts.pdf
[16] Some employer-sponsored plans include 401(k) matching contributions, which are included in this category.
[17] The Retirement Savings Contributions Credit or Saver's Credit is a federal tax credit designed to encourage low- and modest-income individuals save for retirement based on overall income and filing status. Currently, the Saver's Credit is available only to single filers with income up to $27,750 or married filing jointly filers with income up to $55,500. See the Internal Revenue Service, Six Facts on How to Get Credit for Retirement Savings Contributions, available on-line at http://www.irs.gov/newsroom/article/0,,id=107686,00.html
[18] Employee Benefit Research Institute (EBRI), "Individual Account Retirement Plan Assets, by Family Income," Fast Facts, June 23, 2010, available on-line at http://www.ebri.org/pdf/FFE170.23June10.IAs.Final.pdf
[19] *Ibid.*
[20] Bureau of Labor Statistics, Employee Benefits in the United States – March 2010, available on-line at http://www.bls.gov/news.release/ebs2.nr0.htm
[21] *Ibid.*
[22] *Ibid.*