

Controversy 9

WHAT IS THE FUTURE FOR SOCIAL SECURITY?

Social Security is the public retirement pension system administered by the federal government, the largest domestic government program today. Social Security covers all documented U.S. workers except for some state and local government employees. Social Security is essentially a program that collects taxes from employed people (and their employers) and pays benefits to those who are retired. Controversies about the program revolve around the question of how much taxes should be paid and what level of benefits should be paid for those who are retired.

In 2015, 39.5 million retired workers received Social Security benefits. Social Security retirement benefits in 2016 averaged about \$16,128 a year (\$1,344 per month) for a single individual (usually 50% more for a couple), and the majority of older adults rely on Social Security for at least half of their income (National Academy of Social Insurance, 2016). Yet Social Security was never intended to be the sole income source for people in retirement. In fact, the large majority of beneficiaries have other income from a pension, savings, or continued part-time employment. For most retired people, the retirement annuity portion of Social Security is most important because it provides a foundation for retirement income. The broad outlines of Social Security are familiar to most Americans, and the program remains enormously popular and widely supported by American adults of all ages.

But many people today wonder whether Social Security will still be around later in the 21st century. According to Gallup surveys in recent years, nearly half of Americans have repeatedly said they are “not confident” that Social Security will be there for them. At the same time, results from a National Academy of Social Insurance report suggest that there’s widespread support for Social Security from adults ages 18 to 64 as well as across political parties (Reno, Lamme, & Walker, 2011). These somewhat contradictory opinions illustrate how complex and important the issue is: People support Social Security, and they want it to be there for them, but many lack confidence in it. Opinion polls aside, the federal government will be facing difficult choices as the baby boom generation moves into retirement. The number of beneficiaries will rise, but the proportion of contributors to Social Security will decline. Benefits of future Social Security beneficiaries might be lowered; alternatively, the age of eligibility for full retirement benefits could be raised; or, again, future annual cost-of-living adjustments might be diminished. Currently, the federal budget shows a surplus because of Social Security taxes, yet the overall federal budget is in deficit.

In a strict sense, Social Security does not contribute to budget deficits because it is funded separately by a payroll tax. Nonetheless, the Social Security Trust Fund is being reduced as aging boomers begin to collect benefits. The picture will grow more complicated in years to come as political debate around budget deficits continues. While the cost of Social Security remains relatively predictable, most analysts do predict that Medicare will be a bigger factor in deficit debates.

The 1983 Social Security reforms responded to earlier anxiety and succeeded in putting the program on a more secure footing (Light, 1985), but the public rhetoric of “crisis” has continued, eroding public confidence. Part of the problem is that Social Security was created over 75 years ago under different historical conditions. The Social Security Act of 1935 was a centerpiece of the New Deal, a response to the Great Depression at a time when only 5% of the U.S. population was ages 65 and older. This legislation was notable because it acknowledged government’s role in providing income support to individuals outside the labor market. Social Security from the outset was conceived as a form of social insurance. Social Security helped replace income lost and thereby provided a cushion or an incentive to leave the labor force.

MAIN FEATURES OF SOCIAL SECURITY

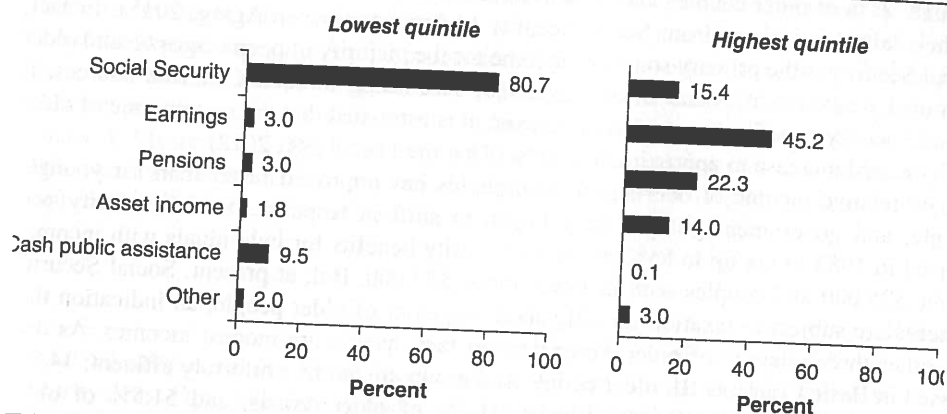
Social Security is actually more than just a retirement income program. It includes other features important to younger age groups. For example, Social Security wage earners are covered by a disability insurance policy worth more than \$200,000 on the private market, and 98% of American children are insured against the loss of a parent. For an average wage earner with two children, Social Security provides the equivalent of \$500,000 in life insurance. Still, what most people think of when they hear the term *Social Security* is the retirement annuity part of the program, which is under consideration here.

The money to fund Social Security comes from its own separate payroll tax, which is compulsory for almost everyone who receives wages or a salary, including people who are self-employed. Other kinds of earnings—such as interest and dividends, partnership income, and so on—are excluded from the tax. The tax on individual wages is 6.2%, but an additional tax is paid by the employer so that the combined payroll tax rate comes to 12.4% with an additional tax for Medicare Part A (also known as Medicare hospital insurance).

Critics have often pointed out that the Social Security payroll tax is a **regressive tax**. That is, a person earning \$20,000 a year and another earning \$106,800 a year pay at the same 6.2% rate. Even a person earning \$1 million a year pays this percentage on only the first \$118,500 of earnings in 2016—and nothing on earnings above that (National Academy of Social Insurance, 2016). By contrast, in a more progressive tax system, such as the federal income tax, the percentage rises as income increases so that wealthier people, at least in principle, pay a greater percentage as well as a greater absolute amount of money in taxes. In contrast, Social Security, as a flat percentage, is a heavier burden for poorer people than for those earning more money (see Exhibit 44).

Social Security was intended to replace around 40% of preretirement income: a figure known as the **replacement rate**. Social Security is modestly progressive in distribution of benefits because the replacement rate is different for high-income or low-income recipients.

Exhibit 44 Shares of Aggregate Income for the Lowest and Highest Income Quintiles, by Source, 2014



SOURCE: *Income of the Aged Chartbook*, 2014, Social Security Administration (2016).

For example, according to the National Academy of Social Insurance (2016), a 65-year-old who retired in 2015 with a lifetime of “medium” earnings (about \$46,290 in 2014) would receive about \$18,320 a year, a replacement rate of 40%. In comparison, a “low” earner who made about \$20,830 in 2014 would receive about \$11,120, which would replace 53% of prior earnings. A worker who always earned the “maximum” taxable amount (\$112,085 in 2014) would get benefits that replace about 26% of prior earnings. Although the percentage replacement rate for higher-wage workers is lower, they do receive more back in absolute dollars.

Another attractive feature of Social Security is that, for more than two decades, benefits have been indexed to the Consumer Price Index (CPI), so benefits automatically increase with inflation. A package of the current Social Security and Medicare benefits with these inflation protection features would be difficult to buy in the private marketplace, and some features—including inflation protection—would be difficult or impossible to buy at all. However, because there was no increase in the CPI from the third quarter of 2014 to the third quarter of 2015, there weren’t any increases in Social Security benefits for 2016 (National Academy of Social Insurance, 2016).

But these benefits come at a price. In 1960, less than 15% of the federal budget was spent on the older population; by the 1990s, the proportion had risen to more than 30%; by 2011, the proportion was 41% for Social Security, Medicare, and Medicaid combined. By 2030, Social Security and Medicare are projected to total 50% of the federal budget (National Center for Policy Analysis, 2011). Looked at from another perspective, Social Security payroll taxes brought in a \$95 billion revenue surplus in 2011, an amount larger than the entire military budget (Johnston, 2012). However, projections for the revenue surplus in 2016 are vastly less, at \$15.7 billion (National Academy of Social Insurance, 2016).

The large reduction in the poverty rate among older Americans that has taken place since the 1960s is partly due to the increase in social insurance benefits such as Social Security. In 2013, 21% of older couples and 46% of nonmarried older adults received 90% or more of their later-life income from Social Security (Administration on Aging, 2015). In fact, Social Security is the primary source of income for the majority of people ages 65 and older (National Academy of Social Insurance, 2016). According to several current sources, if Social Security benefits were no longer to exist, it is estimated that the poverty rate of older adults would increase to approximately 45% (Face the Facts USA, 2012).

The relative income of over-age-65 households has improved faster than for younger people, and government policies have begun to shift in response. Social Security was revised in 1983 to tax up to 85% of Social Security benefits for individuals with incomes above \$25,000 and couples with incomes above \$32,000. But, at present, Social Security benefits are subject to taxation for only about a quarter of older people, an indication that the other three quarters of older Americans, in fact, have quite modest incomes. As discussed in Basic Concepts III, older people as a group are hardly uniformly affluent; 34.7% of older Whites, 49.4% of older Blacks, 41.7% of older Asians, and 51.5% of older Hispanics who receive Social Security rely on it for 90% or more of their income (Office of Retirement and Disability Policy, 2010a).

SUCCESS—AND DOUBT

More than 80 years after its creation, Social Security remains the United States' most successful and perhaps most popular domestic government program. Social Security has long been characterized as *the system that works*, and most Americans would agree with that positive judgment. In recent years there have been calls to expand benefits under Social Security (Altman & Kingson, 2015).

Despite its success and popularity, Social Security has long been a subject of debate (Achenbaum, 1986). One fundamental question concerns the purpose of Social Security: Is it a welfare program designed to prevent impoverishment in old age? Or is it an annuity program that entitles everyone who pays into it to receive proportional benefits? Social Security as it exists has come to embody both purposes. On the one hand, Social Security provides a floor, or minimum income, for almost all older Americans. In this way, it redistributes income. Social Security helps those who are at risk of total disability and helps families with only one wage earner. On the other hand, Social Security is a universal program that benefits both poor and affluent older people. As a result, nearly everyone has a stake in the system.

Any program that tries to accomplish such fundamentally different goals is bound to have both its challenges and its critics. Thus, some people question the basic fairness and integrity of the Social Security system. For example, proponents of the generational equity idea have argued that Social Security is unfair to future generations. They argue that these future cohorts will get back less than do current beneficiaries of the system. According to their view, it might be better for people to have a private pension system instead of a compulsory one like Social Security.

Under some proposals, people could drop out of Social Security and sign up for a personal savings account, hoping to collect a better return than Social Security offers.

But defenders of Social Security point out that better returns are not guaranteed by the private marketplace.

A related criticism is the idea that Social Security is not stable and may not be there for future recipients because the costs will go out of control. There has been much discussion about the dependency ratio, or the proportion of younger workers to retirees. Beginning in the mid-1980s, public opinion polls have repeatedly suggested that the public, particularly younger people, are worried about the future of the system, whether rightly or wrongly (Shaw & Mysiewicz, 2004; Upston, 1998). Worries continue to this day, suggesting that Americans will either have to pay more, or get lower benefits, or perhaps some of both, as happened in 1983 when Social Security was last reformed.

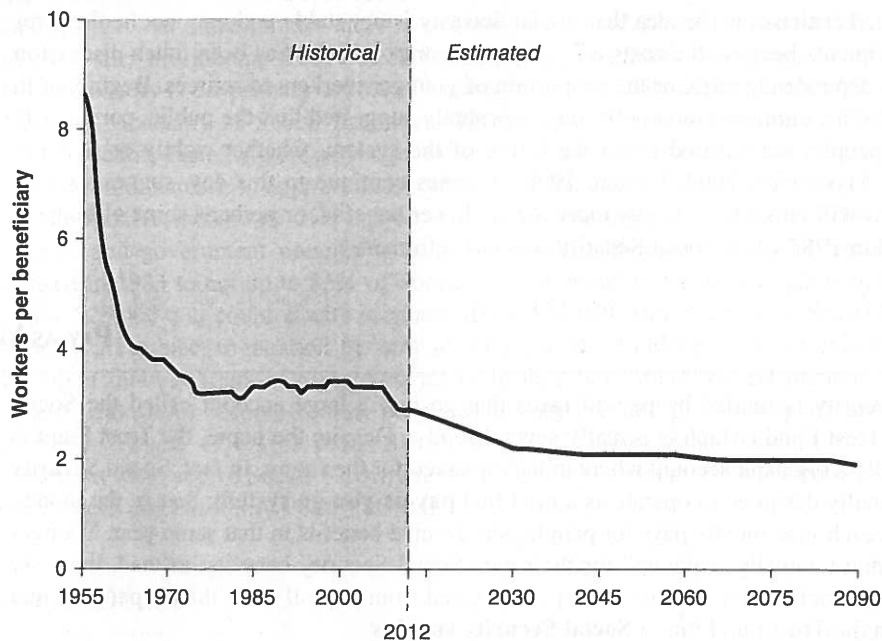
PAY AS YOU GO

Social Security is funded by payroll taxes that go into a large account called the Social Security Trust Fund (which is actually several funds). Despite the name, the Trust Fund is not actually a big bank account where money is saved for the future. In fact, Social Security was originally designed to operate as a modified **pay-as-you-go system**; that is, the money collected each year mostly pays for people who receive benefits in that same year. Younger workers don't actually "save up" for their own Social Security benefits; instead, they pay for current beneficiaries. If more money is collected from payroll taxes than is paid out that year, then the Trust Fund runs a **Social Security surplus**.

Social Security is actually a compact or agreement between different generations. Today's workers pay for today's retirees and hope that future workers will take care of them when they retire, too. Under a pay-as-you-go system, "contributions" to Social Security are actually taxes, not investments. One result of this system, as Martin Feldstein, a conservative economist, points out, is that people feel richer than they really are. If Social Security benefits will be there, maybe people will save less for their retirement.

The fact that Social Security has been a pay-as-you-go system creates some big problems in years to come. The issue is that the baby boom generation is much bigger than the cohort before it or after it. This is a phenomenon demographers call the "pig in the python" pattern, that is, a big bulge in an otherwise skinny snake—or the age distribution—a bulge that moves along as baby boomers grow older (see Exhibit 51 in Controversy 11).

The problem is that the baby boom cohort's contributions are being used to pay for generous benefits for earlier generations, but the "baby bust" group—or the generation of those born after 1964—does not have a large enough number of workers to contribute as much as will be needed under the pay-as-you-go system. In 2015, there were 2.8 workers for each retiree, but by 2035, there will only be approximately 2 workers per beneficiary (see Exhibit 45). Under a pure pay-as-you-go system, this declining ratio presents a big problem, one that if not faced now could result in benefit cuts or a drastic rise in taxes. So what to do? One answer might be to increase the size of the workforce by allowing more immigration to the United States. Another answer might be to improve worker productivity so that a smaller number of workers can generate enough money to pay benefits. And yet another answer might be to continue to increase the age of retirement so that older adults are compelled to remain in the workforce longer. However, there are significant implications for any of these solutions.

Exhibit 45 Ratio of Covered Workers to Social Security Beneficiaries, 1955–2075

SOURCE: Office of Retirement and Disability Policy (2010b).

NOTE: The figures for 2010 and beyond are estimates.

The following question is often raised: Are people getting too low a return on their Social Security contributions? One reason the return is “low” is that Social Security is actually several different programs: a life insurance program, a disability insurance program, and a retirement income program. For the retirement income program, workers today and tomorrow will have to pay for the accumulated promises made in the past. But framing this issue as if Social Security is an investment strategy like buying stocks and bonds may be misleading and problematic.

Proponents of privatizing Social Security believe that the best approach is to permit people to control more of their own savings for retirement. But private accounts alone will not take care of paying for accumulated promises—debts—from the past. Paying off those promises might involve investing part of the Social Security Trust Fund in the stock market, which is one proposal that has been made. Another approach would be to put in money from general tax revenues to make up for any shortfall.

The problem was recognized in the early 1980s. Congress could foresee that, 30 years in the future, the Social Security system could no longer run on a purely pay-as-you-go basis. In 1983, Congress raised the payroll tax rate for Social Security by two percentage points. The idea was to use the extra money to create a larger reserve fund and therefore postpone the day of reckoning when Social Security would run out of money. That tax increase, combined with the dramatic growth of the U.S. economy in the 1990s, dramatically improved the financial health of Social Security.

URBAN LEGENDS OF AGING

“Social Security is going broke; within a few decades, there won’t be any money to pay promised benefits.”

People often assume that “going broke” means there will be no money in the Social Security Trust Fund to pay benefits. That’s not the case. Even if we do *absolutely nothing* at all, by 2034 Social Security will still be able to pay around 79% of benefits, which is hardly the same thing as “going broke.” With modest changes, Social Security could remain solvent for decades beyond that. Policy makers could address solvency, as they did in 1983, by making modest changes in benefits or revenues, keeping Social Security sustainable indefinitely.

SOCIAL SECURITY TRUST FUND

The Social Security Administration projects that Social Security Trust Fund assets will continue to grow. By 2016, the Trust Fund had reached a level of over \$2.8 trillion, and the reserves are projected to grow to \$2.9 trillion by 2019 (National Academy of Social Insurance, 2016). By law, any surplus money in the Trust Fund must go to buy U.S. Treasury notes. In effect, the federal government is borrowing the money and promising to pay it back at a certain time, with interest. The Trust Fund, as discussed earlier, operates on a pay-as-you-go basis.

To understand what this means, imagine that a family is setting aside money to pay for the children’s college education. As college savings accumulate, we can compare the savings with the family’s debts for car payments, credit cards, and so on. We might say that the college savings fund reduces the family’s outstanding debt. But putting the matter that way would be misleading because the savings fund will be rapidly depleted at some time in the not-too-distant future.

The Social Security Trust Fund works the same way. Depending on accounting assumptions, Social Security can be viewed as reducing or paying for part of the current federal budget deficit, just like a family could “borrow” from its college fund to pay off current debts. In this way, the surplus Trust Fund money reduces the need for the government to borrow the money somewhere else, but the “real” deficit is not reduced at all.

There has been considerable debate about just how the Social Security Trust Fund should be viewed: whether as part of the budget, thus reducing the combined federal deficit, or as something completely separate. Defenders of Social Security point out that the program does not increase the federal budget deficit. On the contrary, Social Security collections actually reduce the federal budget deficit because the amount of money collected in payroll taxes each year exceeds what Social Security pays out.

If the payroll tax is a burden, then we might ask, why do we need a surplus anyway? One answer can be found in the Bible’s story of Joseph, in which the ancient Egyptians saved up grain during seven fat years to prepare for seven lean years. So, too, is today’s Social Security surplus really a collection of “IOUs” that will be needed when the baby boom generation starts to retire in large numbers. At that point, the surplus will begin to decline, and problems will begin to arise.

Will Social Security then “go bankrupt”? The term *bankruptcy* seems extreme, but there is a serious imbalance in the system. According to the most recent reports from trustees of the Social Security system, the system is expected to be able to pay full benefits until the year 2034, after which point only 80% of program costs will be funded (Social Security Administration, 2013). Starting in 2024, payment for benefits will begin to exceed revenues. The Trust Fund reserves will need to be drawn down to pay benefits until the Trust Fund is exhausted. This situation—less than one decade in the future—presents a serious problem. Various solutions have been put forward to deal with the shortfall.

For example, Peter Orszag, an economist with the liberal Brookings Institution, has compared Social Security to a car with a flat tire. He argues that it isn't necessary to throw out the car—just fix the flat tire. In a detailed book on Social Security, Diamond and Orszag (2005) offer a proposal to “share the pain” involved in fixing the flat tire. They argue that the Social Security shortfall can be corrected by reducing promised benefits in the future, modestly increasing the tax rate, and raising the maximum level of earnings subject to the payroll tax. Cuts in benefits would be progressive to protect poor people.

The baby boom cohort will probably pay higher taxes on its benefits or else receive somewhat lower benefits for two reasons that have nothing to do with the Trust Fund surplus. In the first place, the \$25,000 income threshold for taxing Social Security is not indexed for inflation, so in the future a much larger proportion of Social Security recipients are likely to have benefits taxed. In the second place, Congress in 1983 decided that the age of eligibility for full Social Security benefits would rise between 2002 and 2007, from age 65, first to 66 and then to 67. A couple retiring prior to the increase in the age of eligibility could recover the money they contributed to Social Security taxes in only 4.5 years. But for those retiring after 2010, it will take 7.5 years—in short, not as good a rate of return. In other words, by waiting longer to receive full benefits, a smaller share of retirees' past earnings will be replaced.

Whether this difference in benefits from one generation to the next is seriously inequitable is another question. Increased life expectancies and different levels of wealth between historical cohorts make comparisons difficult. For example, a recent report from the Urban Institute reveals generational disparities in wealth: The average net worth of Generations X and Y is less than the wealth of their parents at a comparable age, due to student debt, lack of job opportunities, and the reverberations of the recent recession (Steuerle et al., 2013).

None of these arguments about fairness has affected the basic popularity of Social Security with the American public, however, as demonstrated not only by polls but also by the votes of Congress in more than half a century since Social Security came into existence. Legislative support reflects the widespread public support. For example, on the 75th anniversary of Social Security, in 2010, a national survey by the Roper Center for Public Opinion Research showed that support for Social Security remains exceedingly high (see Roper Center for Public Opinion Research, 2011, for the most recent figures). Consistent with earlier surveys in 1995 and 1985, a majority of adults ages 18 and older believe that Social Security is “one of the most important government programs” providing financial security to help older Americans remain independent, though 90% of persons surveyed in a recent poll were concerned that Social Security won't be available for the next generation (Reno & Lavery, 2009).

Despite broad support, however, serious questions have been raised in recent years about aspects of Social Security, and these controversies are at the center of the discussion about its future:

- Should eligibility for Social Security be restricted to people who are most in need?
- Should Social Security be changed, at least in part, into a privatized system of retirement to ensure its integrity in the future?
- Should Social Security be changed to make it more fair in its treatment of women compared with men?
- Will Social Security still be there for future generations who need it?

ELIGIBILITY

To be eligible for full benefits, an older person born in 1937 or earlier must be age 65 (62 for early retirement and reduced benefits) and have worked for 10 years in a job where Social Security taxes were deducted; the age at which one is eligible for full benefits increases for birth cohorts after 1937, to a maximum age of 67 (www.socialsecurity.gov). One way to reduce the cost of Social Security and improve its financing would be to raise the age for those eligible to receive benefits. That shift has already begun and will go into effect as the age of eligibility slowly rises from age 65 to 67 in the coming years. But some observers are asking whether the age of eligibility should be raised even higher, to age 69 or 70 (Hiltzik, 2016).

Some of those arguing for an increased age of eligibility cite rising average life expectancy. In 1940, a 21-year-old man had a 54% chance of living long enough to collect Social Security. But a 21-year-old man in the 1990s had a 72% chance of living to age 65, and a 21-year-old woman had an 83% chance. These odds have only increased as we move farther into the 21st century.

What about longevity after the point of retirement? In 1940, the life expectancy for people surviving to 65 was 12.7 years for men and 14.7 years for women. Today, however, men at age 65 can expect to live 18 years and women 20.5 years (Administration on Aging, 2015). Increasing the age of eligibility by 2 or 3 years would bring the program back to the years of coverage anticipated at the time it was created. However, raising the age of eligibility could create special hardship for minority groups, whose life expectancy is lower than that of Whites. Lower-income people might have to work longer than before at difficult jobs but still be more likely to die earlier than other Americans, and in effect, their benefits would be cut. To counter this possibility, it has been suggested that the level of the minimum Social Security benefit be increased to protect lower-paid workers from late-life poverty (National Academy of Social Insurance, 2011).

Still another approach under consideration is to reduce Social Security benefits to make them reflect the actual rate of inflation. In 1996, an official government commission examining inflation found that the CPI has for years been overstating the rise in the cost of living by 1.1%. The commission estimated that by reducing the CPI to a level equal to actual inflation, the federal government would save \$1 trillion in Social Security benefits (which are linked to the CPI) over a 12-year period. As a result, Social Security would be solid until the mid-21st century. However, an across-the-board reduction in benefits would create the greatest hardship for the poorest beneficiaries.

Another possible solution is to make eligibility for Social Security means tested, that is, available only to people whose income falls below some threshold, such as the Supplemental Security Income (SSI) program. However, the flat SSI benefit paid in 2016 for those over 65

was on average only \$435 per month for an individual, which is a low amount on which to live. Another variation of this approach is the proposal that Social Security benefits be eliminated for people above some threshold—a so-called **affluence test**. This approach is in some ways an extension of the present policy of taxing benefits for higher-income beneficiaries.

Any of these approaches would either reduce expenses or increase revenues. The result might be to place Social Security on a sounder footing. All three approaches would keep Social Security a publicly financed, age-based entitlement program but would shift eligibility in ways that might put the least advantaged at risk in unpredictable ways.

PRIVATIZATION

The term *privatization* can mean several changes from the current public system. One change might be to increase the level of advance funding, that is, to move away from a pay-as-you-go system to a **funded system** that involves a real increase in national savings. This could be accomplished by investing part or all of the Trust Fund in private savings vehicles, such as the stock market. A second meaning of privatization might be to accompany private investment with increased choice over the individual retirement savings, for example, stocks versus bonds. A third meaning of privatization might be to eliminate the way Social Security quietly redistributes benefits, either from one generation to another or from high-wage earners to low-wage earners.

In 1997, a national Social Security Advisory Council recommended several plans that involved some degree of privatization—that is, putting Social Security surplus funds into private investment in the stock market. In recent years, stocks have earned an average range of 6% to 6.8% after inflation—a level much higher than the 3% earned by Social Security funds now invested in Treasury bonds. The potential for greater gain from private investment is what makes privatization attractive to many people. If proponents of privatization are right, then it might be possible to reduce Social Security benefits in the future because people would be getting higher returns from investments in the stock market.

Some plans for privatization could involve keeping the traditional system intact but investing the Trust Fund in a broad index of the stock market. Other plans involve letting individuals decide on their own investment portfolios, for example, giving them the option to invest their Social Security contributions in a small number of government-approved mutual funds. Some advocates of privatizing Social Security favor “carve-outs” or diverting a part of payroll tax revenues to personal accounts. Others favor “add-ons” or creation of government-subsidized private accounts that would not be taken out of payroll taxes going to the current Social Security program. Whatever form that privatization might take, investing in the stock market would not be cost free because the federal government would have to borrow directly from the public, thus raising taxes indirectly.

The other question about privatization is how to make the transition from today’s system to a more privatized form of Social Security. To finance this, the federal government would have to borrow money to make up for retirement benefits already promised to people now retired or near retirement age. Those “transition costs” would mean higher taxes on top of those currently paid for Social Security. Under the boldest privatization plan, transition costs could require higher taxes equal to \$6.5 trillion over a 70-year period. As economist Barry Bosworth (1996) has noted, shifting to a funded system

means that members of a "transition generation" would have to pay twice: for their own future retirement and for those in the current system.

One big problem with investing Social Security funds in the stock market is the size of the Trust Fund. It is estimated that by the year 2015, the federal Social Security Trust Fund will own \$800 billion in shares, or 10% of the entire stock market, which would be a dramatic shift toward national influence over the capital markets. Critics of the plan note that, although investing in a broad stock index should provide some diversification and safety, putting Social Security funds at risk in the stock market is not necessarily prudent. True, stocks have risen at a high average rate since 1926, but the U.S. stock market dropped abruptly in the year 2008 and has been volatile ever since.

Conservative critics of Social Security, such as economist Martin Feldstein, have long argued that a public pension program weakens private savings and capital formation. They often point to Chile as an example of successful transition to a privatized system. Other countries, such as Finland, Brazil, and Australia, have experimented with shifting public pensions to stock market investment to improve national savings. But questions have been raised about investing Social Security funds in the stock market. What impact would forced savings plans really have on other voluntary savings and capital formation? Could federal government ownership of stocks lead to other intervention in the markets, for example, forbidding Social Security from buying tobacco stocks? What happens in a crash, such as we experienced in the Great Depression of the 1930s or the economic downturn beginning in 2008?

What about allowing workers to invest part of their Social Security taxes in private retirement accounts? On the positive side, this plan would give individuals the freedom to make their own decisions about investing for retirement, as they do with 401(k) plans now. But studies by the Employee Benefit Research Institute suggest that lower-income workers tend to be much too cautious in their investments, and as a result, their savings do not grow as much over time. However, if people do make riskier investments, they are vulnerable to losing their retirement savings. Still another problem is how to help investors ride out the stock market's periodic ups and downs over time. What would holders of individual accounts do if the market took a long downturn?

The effect of changing Social Security into private retirement accounts would be to emphasize equity over adequacy in the operation of the system as a whole. Social Security has always embodied two different, sometimes contradictory principles: equity, which means a fair return to beneficiaries depending on how much they contribute to the system, and **adequacy**, which means maintaining a decent minimum of income for everyone. Some degree of privatization might make Americans more confident in Social Security, but by favoring equity over adequacy, privatization could be the first step toward dismantling a system that has been popular and successful for the better part of a century.

The issue of equity versus adequacy comes up when people argue that they could do better by saving and investing Social Security benefits on their own. This argument makes us realize that Social Security represents a transfer of wealth from younger to older people. Higher-wage earners get back higher Social Security benefits than lower-wage earners, but the higher-wage earners do not get back as much as they would if they invested the money and received the gains for themselves alone. In effect, Social Security involves a modest redistribution of wealth to give a more adequate level of benefits to lower-wage earners. The conflict between equity and adequacy comes up when we look at how different generations and different wage earners do under the current system.

GLOBAL PERSPECTIVE

The New Swedish National Pension System

Should pensions for retirement be given by government, or should individuals be expected to save for themselves? One answer to this question may come in the new Swedish National Pension System, introduced in 2000. The Swedish system is an individual defined-contribution plan, and participation is public and mandatory. The Swedish approach requires shared employee-employer contributions, and employees can choose from 650 different mutual funds, where these funds are invested collectively on behalf of employees. The Swedish government itself offers two stock funds, charging very low fees. Participants in all the plans also have considerable flexibility in payout choices. The new Swedish National Pension System, therefore, offers both mandatory participation and voluntary options as a way for participants to save for retirement.

The new Swedish National Pension System is a distinctive institution in a country that has a strong tradition of capitalism and free markets balanced by a strong public sector. Swedish citizens are accustomed to paying high taxes but also want to find ways to save more for their own retirement. The new public-private system in Sweden is added on to an already generous public pension provision in a country with a long commitment to social welfare. The result is a blend of safety and individual choice. But the picture is not all rosy. As with any stock investment plan, there are inevitable risks. For example, Swedish investors lost money in the bear market after 2001. Perhaps as a result of that negative experience, 90% of those recently participating in the system pick the "default" option of the Swedish government's own funds. But citizens do have a choice, and the new Swedish National Pension System continues to attract interest around the world.

SOURCE: Weaver, R. K., "Design and Implementation Issues in Swedish Individual Pension Accounts," *Social Security Bulletin* (2003–2004), 65(4): 38–56.

WOMEN AND SOCIAL SECURITY

Social Security with respect to gender is completely neutral: Men and women are treated the same with regard to benefits related to earnings. Yet women depend on Social Security more than men. In 2014, women ages 62 and older represented 50% of all Social Security beneficiaries; by age 85, women represent more than two thirds of all beneficiaries. But women, on average, still earn less than men, and benefits are linked to earnings.

The debate about privatization of Social Security raises unresolved questions: for example, how Social Security treats men and women over the life course, and how this differential treatment disadvantages older women. Some issues have come to the forefront over the past few decades because of changing social conditions, such as the role of women (MacDonald, 1998). For example, a married woman is entitled to 50% of her retired spouse's earned Social Security benefits and a higher amount if the husband dies. But if a woman earned Social Security benefits on her own wage record, she would not receive any of those benefits if she receives a spousal or widow's benefit based on marriage status. As a result, Social Security as

presently constructed tends to favor widows but discourages a “secondary” earner. One only need to consider average Social Security benefits according to gender to see that there’s a disparity: In 2014, the average Social Security benefit for women ages 62 and older was about \$14,000 per year, compared to about \$17,856 for men ages 62 and older (Social Security Administration, 2014). Yet older women rely on Social Security even more than older men do (National Women’s Law Center, 2012).

Many people argue that Social Security hasn’t changed to recognize changes in gender roles. When Social Security first went into effect in the 1930s, it took for granted a traditional family structure: a male breadwinner and a stay-at-home mother. The Social Security program was originally planned for a one-earner family, but today more than 70% of women between the ages of 20 and 44 are in the labor force. Social Security seeks to treat both men and women fairly, but there are troublesome equity problems related to caregiving, divorce, and two-earner couples (Estes, 2004; Johnson, 1987).

The rate of poverty and near poverty among older women is shockingly high, as discussed in *Basic Concepts III* (Munnell, 2004). In 2014, 12% of women ages 65 and older were living in poverty, compared to 7.4% of men (Social Security Administration, 2016). Widowhood is a distinct threat to well-being: Almost four times more widows live in poverty than do married women of comparable age (Karamcheva & Munnell, 2007).

Women’s wages remain about three quarters of men’s, and that gap widens in retirement. Taking time out to raise families or to care for older relatives reduces the primary insurance amount credited under Social Security. Leaving the workforce to care for others, whether early or late in a career, is more costly for women with low and moderate earnings. As a result, women may fail to earn enough during their working lives to be able to save on their own for retirement. A basic problem is that the Social Security system recognizes only paid work for determining benefits. The nonmonetized work that women do in caring for family members receives no acknowledgment. These facts lead some observers to recommend earnings sharing for Social Security or even credit for years of lost wages due to caregiving.

Another equity issue arises from today’s higher divorce rate. Under Social Security, women who have been married less than 10 years and who were out of the labor force during those years receive no credits toward Social Security, meaning lower benefits at retirement. As a result of past reforms, women who are divorced are eligible for a spousal benefit if they were married at least 10 years. Nevertheless, those who are divorced receive only a third of what the couple would have received had they stayed together.

Still another issue arises from the way that Social Security treats married couples. When a woman retires, she automatically receives a spousal benefit equivalent to half of that to which her husband is entitled. Unless married women have earned a great deal, their spousal benefits are higher than the level they would get from their own work history. Social Security will give benefits to a woman for work outside the home only when her accumulated benefits are greater than her husband’s. Typically, then, older women’s lifetime economic contribution to Social Security is totally disregarded, and two-earner couples may receive proportionately lower retirement benefits than one-earner couples under the present system. Some critics find that inequitable.

The issue here is related to the question of fairness in Social Security—namely, equity versus adequacy. Women who are eligible for Social Security receive a benefit based on their own earnings record. But if they have been married, they are also entitled to a benefit based

on the earnings record of their spouse. In other words, a married woman (or widowed or divorced woman) can be dually entitled to Social Security benefits. In recent decades, more and more women have been eligible for benefits in this way. As a result, dropping out of the labor force to care for children or other dependents may be offset by a share of the spouse's earnings record (Munnell, 2004). In fact, the proportion of women ages 62 and older who receive dependent benefits on the basis of their husband's earnings only has been declining over the past several decades. In 2014, 23% received dependent benefits, compared to 57% in 1960. Over the same period, the proportion of women ages 62 and over receiving dual entitlement—based on both their own earnings records and their husband's—has increased, from 5% in 1960 to 26% in 2014 (Office of Retirement and Disability Policy, 2015).

Some suggestions have been made to reform the Social Security system to take into account a woman's life cycle (Morgan, 2000). Some critics have urged that Social Security give credit for time taken out for caregiving, and the National Academy of Social Insurance has suggested that allowing child care years to count toward Social Security benefits is an option for improving the adequacy of benefits. But the 2011 Social Security Caregiver Credit Act, a bill proposing that up to five years of caregiving for a dependent relative be credited toward Social Security benefits, wasn't put into law. A related proposal is for Social Security caregivers to simply eliminate up to 5 years of low earnings if those years were devoted to caregiving responsibilities.

One problem is that a child care dropout credit might favor economically advantaged women, who can afford to take time off for child rearing more than those who are disadvantaged. But many European countries have a similar system of implicitly subsidizing child care through children's allowances. Another suggestion to help women would be the "double-decker system," under which a retiree would receive a minimum fixed amount of money along with a benefit related to work history and prior contributions (Burkhauser, 1984).

Finally, some women's advocates have urged an **earnings sharing** plan, which would divide the total earnings of the married couple between the Social Security accounts of both spouses (Iams, Reznik, & Tamborini, 2009). Earnings sharing is attractive because it treats marriage as a partnership of equals, and it also helps improve the retirement income of women who may be impoverished by divorce or widowhood. But the idea of earnings sharing brings us back to a fundamental question concerning the rationale for Social Security: Is the program to be viewed as a means for replacement of earnings or as an investment judged by equity and rate of return? Would complete privatization of Social Security be good for women (Estes, 2004; Williamson, 1997)? People have different ways of thinking about fairness and adequacy, and basic social values are at stake. However these debates are resolved, Social Security will remain a key issue for women.

What about the impact of privatization for women on Social Security? Here, opinions differ. Some observers believe that privatizing Social Security would be good for women precisely because changes in family structure have opened up more opportunities for women to control their own earnings. Privatization would encourage greater individual choice, in keeping with values of contemporary feminism (Tanner, 2004). However, privatization could have particularly severe effects for older women whose life courses have not closely matched the "traditional" family model of marriage with a male breadwinner, as well as for women suffering from disadvantages of ethnicity, race, and social class.

DEBATE OVER SOCIAL SECURITY

In the readings that follow, we encounter some different views about the future of the Social Security system. Privatization is rejected by Peter A. Diamond and Peter R. Orszag. They too acknowledge that the Social Security Trust Fund faces a long-term deficit, but they are opposed to diverting payroll tax revenues into private accounts. Instead, Diamond and Orszag argue that modest incremental changes can trim benefits and increase revenues while keeping the basic system intact. They are concerned about maintaining Social Security's role as a collective form of social insurance instead of a vehicle for individual investment.

In contrast, Ramesh Ponnuru gives a strong case for why the current pay-as-you-go system cannot survive. He believes that personal savings accounts are an idea whose time has come and are a better way to accomplish the goals that Social Security was intended to achieve. Ponnuru's approach is a form of partial privatization, similar to what President George W. Bush proposed in the great Social Security debates of 2005.

The 2005 debate around private accounts brought to the forefront the familiar conflict between equity and adequacy as goals for Social Security. Even without further changes in the system, the 1983 reforms are now increasing the age of eligibility for full benefits from age 65 up to 66 and then 67 over a period of decades. Some voices have urged raising the age still higher. But Lawrence H. Thompson points out that any rise in the retirement age is an across-the-board benefit cut that hits hardest at the least advantaged. He concludes that, to reform Social Security, we have to face difficult choices.

The role of family and gender relationships in Social Security is another topic that deserves more attention than it received in the 2005 debates. C. Eugene Steuerle and Melissa Favreault raise some critical questions about how Social Security benefits are paid out to married couples and single people. They argue that Social Security now treats beneficiaries



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Citizens in favor of protecting Social Security rally on the U.S. Capitol grounds before lobbying Congress on this issue.

in ways that are unequal and unfair because the system doesn't reflect the reality of family life in the 21st century. Beyond the debate over private accounts, they urge a debate over other kinds of unfairness in the Social Security system. Finally, the "pros" and "cons" of various current solutions proposed to solve the Social Security "crisis" are offered in a non-partisan piece from AARP.

FOCUS ON PRACTICE

Investment Decisions for Retirement Income

"Investing for retirement? Oh, that's so far off! I've got more important things to worry about right now." Does that statement sound familiar? If you're young, it may sum up your sentiments about investing for retirement. If you're a bit older, you might have different thoughts that are no more realistic: "Investing for retirement? Oh, I'm already in a pension plan, and besides I'm covered by Social Security."

Ignoring the problem of retirement income because it's far off or assuming it's already "taken care of" is unwise. For one thing, the proportion of American workers covered by employer-paid pension plans has not been growing in recent years. As more and more employees who have pensions are under defined-contribution plans, retirement income becomes less predictable, and individuals need to plan more carefully.

In short, when it comes to pension coverage, more and more workers are on their own. In the early years of the 21st century, the shift is away from "someone else" taking care of retirement planning toward individuals making more investment decisions on their own.

As for Social Security, we know that a large proportion of younger Americans lack confidence in its future even while supporting its solvency in the present. Even if their pessimism is mistaken, Social Security was never intended to cover more than a portion of retirement income. Social Security benefits and private pensions, taken together, constitute an important part of the assets of older people. Decisions about retirement—such as assigning pension survivor rights and choosing whether to accept an early retirement offer—are some of the most important financial decisions a person will make over the life course.

If we account for all these factors, the conclusion is conveyed by the title of a classic book by Robert Butler and Kenzo Kiikuni (1993): *Who Is Responsible for My Old Age?* The answer is, "I am responsible myself," and retirement in the future will require more careful financial planning than in the past.

A key idea for investment planning is to invest with a life course perspective in mind—that is, to think about age and tolerance for risk. Psychological studies tell us that people tend to become more risk averse as they grow older. Some risk aversiveness is quite rational. With advancing age, the bad consequences for risky behavior become more severe. If you have a skiing accident, it takes longer for bones to heal; if you're widowed or divorced, the odds of remarriage become worse; and if you make a bad investment, it's more difficult to recover.

What does risk aversiveness suggest about investing for retirement? One response might be to shift savings away from more volatile and risky assets—such as the stock market—in favor of safe, fixed-income investments, such as savings accounts, certificates of deposit, and U.S. Treasury bills.