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"Saving" Social Security Is Not Enough

by Michael Tanner

Executive Summary

It seems that no politician discusses Social Security these days without a call to "save" the program. Certainly, it is possible to see why the program needs saving. It is facing financial insolvency: it is more than $20 trillion in debt and will be running a deficit in just 15 years.

But to focus on "saving" Social Security is to miss the larger point. Merely finding sufficient funding to preserve Social Security fails to address the serious shortcomings of the current system. The question should be, not whether we can save Social Security, but whether we can provide the best possible retirement system for American workers. Social Security fails both as an anti-poverty program and as a retirement program. It contains numerous inequities and leaves future retirement benefits to the whims of politicians. Why should the goal of public policy be to save such a program?

Instead of saving Social Security, we should begin the transition to a new and better retirement system based on individually owned, privately invested accounts. The new system would allow workers to accumulate real wealth that would prevent their retiring to poverty. Because a privatized system would provide a far higher rate of return, it would yield much higher retirement benefits. Because workers would own their accounts, money in them could be passed on to future generations as an inheritance. That would particularly benefit the poor and minorities. Finally, workers would no longer be dependent on politicians for their retirement incomes.

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Introduction

We need to *save Social Security*.
—President Bill Clinton[1]

I'm fighting to *save Social Security* the right way.
—Vice President Al Gore[2]

My economic agenda sets aside $ 2 trillion of the $4 trillion unified budget surplus to *save Social Security*.
—Gov. George W. Bush[3]

We should work on a real plan that *saves Social Security*.
—Rep. Bill Archer (R-Tex.)[4]

The corridors of Washington are ringing with calls to "save" Social Security. And it is certainly easy to understand why the program needs "saving." Social Security is rapidly heading for financial insolvency. By 2015 the program will begin running a deficit, paying out more in benefits than it takes in through taxes. The resulting shortfall will necessitate at least a 50 percent increase in payroll taxes, a one-third reduction in benefits, or some combination of benefit cuts and tax increases. Overall, Social Security faces a long-term funding shortfall of more than $20 trillion.[5]

As a result, there have been numerous proposals designed to shore up the program's shaky finances. Those proposals generally take one of two tracks: setting aside current Social Security surpluses in some form of "lock box" or injecting general revenue financing into the system.

There are serious flaws in both of those approaches. The lock-box proposals do not, in fact, do anything to change Social Security's financing. Currently, surplus Social Security taxes are used to purchase government bonds, which are held by the Social Security trust fund. Those bonds will eventually have to be repaid. To do so, the government will have to raise revenue. Thus the bonds represent nothing more than a claim against future tax revenues, in essence a form of IOU.[6] Revenue from the purchases of those bonds is credited to the unified federal budget and used to pay the general operating expenses of the federal government. Under lock-box proposals, the revenue from the purchase of the bonds could be used only to pay down the national debt. Paying down the national debt may or may not be a good thing, and it may make it easier for the federal government to borrow money in the future, but it does nothing to change the date at which Social Security will begin to run a deficit. As the *Washington Post* has pointed out, "The same IOUs are put in the trust fund whether the surplus is used to finance other programs or pay down debt."[7]

Some proposals go beyond setting aside Social Security surpluses and would inject all or part of the current general revenue budget surpluses into the Social Security system. Aside from the fact that Social Security's liabilities far outstrip the amount of surplus available, it is impossible to prefund Social Security under the program's current structure. Any additional funds put into the system today would simply purchase more government bonds, which would have to be paid in the future from whatever tax monies were available then.

However, setting aside the important point that none of the current proposals to save Social Security actually does so, the current focus on "saving" Social Security is itself misguided. Merely finding sufficient funding to preserve Social Security fails to address the serious shortcomings of the current system. The question should be, not whether we can save Social Security, but whether we can provide the best possible retirement system for American workers. Such a system should keep seniors out of poverty as well as improve prospects for future generations. It should provide an adequate retirement income and the best possible return on an individual's money. It should be fair, treating similarly situated people equally. Certainly, it should not penalize the disadvantaged in society such as the poor and minorities. And it should allow people to own their benefits, freeing seniors from dependence on politicians and politics for retirement benefits.

On all those scores, Social Security is an abysmal failure. It fails both as an anti-poverty program and as a retirement program. It contains numerous inequities and leaves future retirement benefits to the whims of politicians. Why should the goal of public policy be to save such a program?

Instead of saving Social Security, we should begin the transition to a new and better retirement system based on individually owned, pri-

vately invested accounts. A privatized system would allow workers to accumulate real wealth that would prevent their retiring to poverty. Because a privatized system would provide a far higher rate of return, it would yield much higher retirement benefits. Because workers would own their accounts, money in them could be passed on to future generations. That would particularly benefit the poor and minorities. Finally, again because workers would own their retirement accounts, they would no longer be dependent on politicians for their retirement incomes.

Social Security as an Anti-Poverty Program

Social Security has elements of both an insurance and a welfare program. It is, in effect, both a retirement and an anti-poverty program.[8] Although people most often think of the retirement component of the program, the system's defenders often focus on its anti-poverty elements. For example, Rep. Bill Archer (R-Tex.), chairman of the House Ways and Means Committee and author of a proposal to save Social Security, calls the program "the country's greatest anti-poverty program."[9] But is it really?

There is no question that the poverty rate among the elderly has declined dramatically in the last half century. As recently as 1959, the poverty rate for seniors was 35.2 percent, more than double the 17 percent poverty rate for the general adult population.[10] Today, it has declined to approximately 11.9 percent.[11]

Clearly, Social Security has had a significant impact on that trend. A 1999 study by the Center on Budget and Policy Priorities found that in the absence of Social Security benefits approximately 47.6 percent of seniors would have incomes below the poverty level.[12] That suggests that receipt of Social Security benefits lifted more than 35 percent of seniors, approximately 11.4 million people, out of poverty. CBPP also points out that the percentage of elderly who would have been in poverty in the absence of Social Security has remained relatively constant over the last several decades, while the percentage of elderly in poverty after receiving Social Security benefits has been steadily declining, indicating the increased importance of Social Security as an anti-poverty remedy.[13]

The primary problem with this line of analysis is that it assumes that any loss of Social Security benefits would not be offset by income from other sources. In other words, it simply takes a retiree's current income and subtracts Social Security benefits to discover, no surprise, that total income is now lower and, indeed, frequently low enough to throw the retiree into poverty.

Social Security benefits are a substantial component of most retirees' income. Those benefits constitute more than 90 percent of retirement income for one-quarter of the elderly. Nearly half of retirees receive at least half of their income from Social Security.[14] The question, therefore, is not whether the sudden elimination of Social Security income would leave retirees worse off—clearly it would—but whether in the absence of Social Security (or an alternative mandatory savings program) retirees would have changed their behavior to provide other sources of income for their own retirement.

For example, we could ask how many seniors, in the absence of Social Security, would still be working. If they were, they would have a source of income not considered by the CBPP study. Clearly, not all seniors are able to continue working. However, many can and would. Indeed, Congress recently repealed the Social Security earnings test precisely because there are many seniors who *want* to continue working.

A more important question is whether workers, without Social Security to depend on, would have changed their behavior and saved more for their retirement. The evidence is strong that Social Security discourages individual savings. For example, Martin Feldstein of Harvard University and Anthony Pellechio of the National Bureau for Economic Research have found that households reduce their private savings by nearly one dollar for every dollar of the present value of expected future Social Security benefits.[15] Other studies have put the amount of substitution somewhat lower but still indicate a substantial offset. Even two researchers for the Social Security Administration, Dean Leimer and David Richardson, have conceded that "a dollar of Social Security wealth substitutes for about three-fifths of a dollar of fungible assets."[16]

Therefore, given that many seniors would have replaced Social Security income with income from other sources, the impact of

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Social Security on reducing poverty among the elderly may be overstated.

However, even taking the arguments of Social Security's defenders on their own terms, the evidence suggests that Social Security fails as an anti-poverty tool. After all, despite receiving Social Security benefits, nearly one of eight seniors still lives in poverty. In fact, the poverty rate for seniors remains slightly higher than that for the adult population as a whole.[17]

For some subgroups, the problem is far worse. For example, although the poverty rate for elderly married women is relatively low (6.4 percent), the poverty rate is far higher for elderly women who never married (21.1 percent), widowed women (21.5 percent), and divorced or separated women (29.1 percent).[18] African American seniors are also disproportionately left in poverty. Nearly 30 percent of African Americans over the age of 65 have incomes below the poverty level.[19]

Social Security's failure as an anti-poverty program is not surprising since Social Security benefits are actually quite low. A worker earning the minimum wage over his entire working life would receive only $6,301 per year in Social Security benefits, well below the poverty level of $7,990. As mentioned above, poor seniors receive nearly 80 percent of their retirement income from Social Security. Many have no other income at all. Social Security is insufficient to raise those seniors out of poverty.

This can be contrasted with what those people would have received had they been able to invest their payroll taxes in real capital assets. For example, if the minimum wage worker described above had been able to invest his payroll taxes, he would be receiving retirement benefits of $20,728 per year, nearly three times the poverty level.[20] Clearly, by forcing workers to invest in the current pay-as-you-go system, rather than in real capital assets, Social Security is actually contributing to poverty among the elderly.

Social Security essentially forces low-income workers to annuitize their wealth, preventing them from making a bequest of that wealth to their heirs.

Not only does Social Security contribute to poverty among current seniors, it also helps perpetuate poverty for future generations. Social Security benefits are not inheritable. A worker can pay Social Security taxes for 30 or 40 years, but, if that worker dies without children under the age of 18 or a spouse over the age of 65, none of the money paid into the system is passed on to his heirs.[21] As Jagadeesh Gokhale, an economist at the Federal Reserve Bank of Cleveland, and others have noted, Social Security essentially forces low-income workers to annuitize their wealth, preventing them from making a bequest of that wealth to their heirs.[22]

Moreover, because this forced annuitization applies to a larger portion of the wealth of low-income workers than of high-income workers, it turns inheritance into a "disequalizing force," leading to greater inequality of wealth in America. The wealthy are able to bequeath their wealth to their heirs, while the poor cannot. Indeed, Gokhale and Boston University economist Laurence Kotlikoff estimate that Social Security doubles the share of wealth owned by the richest 1 percent of Americans.[23]

Feldstein reaches a similar conclusion. He suggests that low-income workers substitute "Social Security wealth" in the form of promised future Social Security benefits for other forms of savings. As a result, a greater proportion of a high-income worker's wealth is in fungible assets. Since fungible wealth is inheritable, whereas Social Security wealth is not, a small proportion of the population holds a stable concentration of fungible wealth.[24] Feldstein's work suggests that the concentration of wealth in the United States would be reduced by as much as half if low-income workers were able to substitute real wealth for Social Security wealth. Individual accounts would allow them to do so.

Thus, far from being "the country's greatest anti-poverty program," Social Security appears to do a poor job of lifting seniors out of poverty and may in fact perpetuate their poverty while increasing inequality in this country.

Social Security as a Retirement Program

If Social Security is an inadequate anti-poverty program, does it at least meet its second goal as a retirement program? When Franklin Roosevelt proposed Social Security, he promised a program that would provide retirement benefits "at least as good as any American could buy from a private insurance company."[25] While that may have been true at one time, it certainly is no longer the case.

Social Security's rate of return has been steadily declining since the program's inception and is now far lower than the return from private capital investment. According to the Social

Security Administration, workers born after 1973 will receive rates of return ranging from 3.7 percent for a low-wage, single-income couple to just 0.4 percent for a high-wage-earning single male.[26] The overall rate of return for all workers born in a given year was estimated at slightly below 3 percent for those born in 1940, 2 percent for those born in 1960, and below 1 percent for those who will be born this century.[27] Numerous private studies predict future rates of return for an average-wage earner ranging from 2 percent to a negative 3 percent.[28]

To make matters worse, the studies generally assume that Social Security will be able to pay all its promised benefits without increasing payroll taxes. However, the Social Security system is facing a long-term financial shortfall of more than $20 trillion. According to the system's own Board of Trustees, either taxes will have to be raised by at least 50 percent or benefits reduced by 25 percent. As a result, the rate of return will be even lower than the rates cited above. In many cases the return will actually be negative.[29]

By comparison, the average rate of return to the stock market since 1926 has been 7.7 percent.[30] That return has held despite a major depression, several recessions, World War II, two smaller wars, and the turbulent inflation-recession years of the 1970s. Of course, there have been ups and downs in the market, but there has been no 20-year period since 1926 during which the market was a net loser. Indeed, there has never been a 20-year period in which the market performed worse than projected future returns from Social Security.[31]

Even corporate bonds have consistently outperformed Social Security. Discounting the period 1941–51, when government price controls artificially reduced the return, corporate bonds have paid an average real annual return of more than 4 percent.[32]

Thus, because it deprives American workers of the ability to invest in private capital markets, the current Social Security system is costing American retirees hundreds of thousands of dollars. A single-earner couple, whose wage earner is 30 years old in 2000 and earning $24,000 per year, can expect to pay more than $134,000 in Social Security taxes over their lifetimes and receive $292,320 in lifetime Social Security benefits (including spousal benefits), assuming that both husband and wife live to normally expected ages.[33] However, had they been able to invest privately, they would have received $875,280.[34] That means the current Social Security system is depriving them of more than half a million dollars.

A second way to consider Social Security's adequacy as a retirement program is to look at the replacement rate, that portion of preretirement income replaced by Social Security benefits. Most financial planners say that a person will need retirement benefits equal to between 60 and 85 percent of preretirement wages in order to maintain his or her standard of living.[35]

However, Social Security provides only 42.4 percent of preretirement income for average-income workers. Because Social Security has a progressive benefit formula, low-income workers do better with a replacement rate of 57.1 percent, still below what is needed. That is especially true since low-income workers lack other forms of retirement income. The replacement rate for high-income workers is only 25.6 percent. In the future, the situation will grow even worse. Even under current law, replacement rates are scheduled to decline significantly. By 2030 Social Security will replace only 36.7 percent of an average-wage earner's preretirement income. However, because Social Security cannot pay all promised future benefits, the Congressional Research Service estimates that the replacement rate for an average worker will decline to as low as 26 percent, a 40 percent decline from the current already inadequate levels.[36] Clearly, Social Security, both now and in the future, leaves many seniors without the income necessary to maintain their standard of living.

Again, compare this with the replacement rates provided under a system of private investment. Assuming that the worker described previously were able to invest the full nondisability portion of his Social Security taxes (10.6 percent of wages), his replacement rate would be an astounding 260 percent of preretirement income! If he invested just 4 percent of wages, he would still have a replacement rate equal to 100 percent of his preretirement income.

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Social Security Is Unfair

As if it were not bad enough that Social Security fails in its stated mission as an anti-

poverty and retirement program, the program also contains very serious inequities that make it fundamentally unfair.

The program's most obvious unfairness is *intergenerational*. Retirees currently receiving benefits paid a relatively low payroll tax over their working lifetimes and receive a fairly high rate of return. That high return is subsidized by much higher payroll taxes on today's young workers who, in turn, can expect much lower future benefits. As Daniel Shapiro, professor of philosophy at West Virginia University, has pointed out, one of the basic precepts of social justice is the minimization of *unchosen* inequalities.[37] However, the future generations forced to bear the burden of Social Security's unfunded liabilities must do so entirely because of the time of their birth and not through any fault or choice of their own.

The program's *intragenerational* inequities are less visible but just as unfair. As we have already noted, Social Security benefits are not inheritable. Therefore, lifetime Social Security benefits depend, in part, on longevity. As a result, people with identical earnings histories will receive different levels of benefits depending on how long they live. Individuals who live to be 100 receive far more in benefits than individuals who die at 66. Therefore, those groups in our society with shorter life expectancies, such as the poor and African Americans, are put at a severe disadvantage.

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Of course, Social Security does have a progressive benefit formula, whereby low-income individuals receive proportionately higher benefits per dollar paid into the system than do high-income workers.[38] The question, therefore, is to what degree shorter life expectancies offset this progressivity.

The findings of studies that use income as the sole criterion are mixed. Some studies, such as those by Eugene Steuerle and Jan Bakja of the Urban Institute and Dean Leimer of the Social Security Administration, conclude that shorter life expectancies diminish but do not completely offset Social Security's progressivity.[39] However, there is a growing body of literature—including studies by Daniel Garrett of Stanford University, the RAND Corporation, and others—that shows that the progressive benefit formula is completely offset, resulting in redistribution of wealth from poor people to the already wealthy.[40]

The question of Social Security's unfairness to ethnic minorities appears more straightforward, particularly in the case of African Americans. African Americans of all income levels have shorter life expectancies than do whites. As a result, a black man or woman, earning exactly the same lifetime wages and paying exactly the same lifetime Social Security taxes as his or her white counterpart, will likely receive far less in lifetime Social Security benefits. For example, assume that a 30-year-old black man and a 30-year-old white man both earn $30,000 per year over their working lifetimes. By the time they retire, they will each have paid $136,740 in Social Security taxes over their lifetimes[41] and will be entitled to monthly Social Security benefits of $1,162. However, the white man can expect to live until age 81.[42] If he does, he will receive $189,389 in total Social Security benefits. The black man, in contrast, can expect to live only to age 79.[43] He can expect to receive only $161,750, almost $27,000 less than his white counterpart. This may actually understate the unfairness of the current system, since it is based on life expectancies at age 65. However, if both men are age 30 today, the life expectancy for the white man is 78; for the black man it is only 69.[44] If those projections are accurate, the black man can expect to receive nearly $100,000 less in lifetime Social Security benefits than his white counterpart and, indeed, will receive less than half what he actually paid into the program.

It seems amazing that this disparate impact, which would not be tolerated in any other government program, is so easily accepted within the current Social Security system.[45]

The current program is also unfair to women who work outside the home. Under the current system, a woman is automatically entitled to 50 percent of her husband's benefits, whether or not she has worked outside the home or paid Social Security taxes.[46] However, if a woman is able to claim benefits both as a spouse and in her own right, she may receive only the larger of the two. Because many women work only part-time, take years off from work to raise children, or earn lower wages than their husbands, 50 percent of the husband's benefits is frequently larger than the benefits a woman would be entitled to as a result of her own earnings. She will, therefore, receive only the benefits based on her husband's earnings. She will receive no additional benefits even though she

may have worked and paid thousands of dollars in payroll taxes. Indeed, she would receive exactly the same benefits as if she had never worked a day outside the home or paid a dime in Social Security taxes. The taxes she paid earn her exactly *nothing*.[47]

Anyone concerned with fairness and equity in government programs must acknowledge that our current Social Security system falls far short of meeting those goals.

Social Security and the Dignity of Older Americans

Finally, it should be noted that the current Social Security system makes American seniors dependent on government and the political process for their retirement income. In essence, it reduces American seniors to supplicants, robbing them of their dignity and control over their own lives.

Americans, of course, do not get back the money that they individually paid into Social Security. Under our pay-as-you-go Social Security system, the money that workers pay in Social Security taxes is not saved or invested for their own retirement; it is instead used to pay for benefits for current retirees. Any overpayment is used by the federal government to pay its general operating expenses or, under various lock-box proposals, to pay down the national debt.

In exchange, workers receive a promise that the government will tax future workers in order to provide benefits to today's workers when they retire. However, that promise is not any sort of legally enforceable contract. It has long been settled law that there is no legal right to Social Security. In two important cases, *Helvering v. Davis* and *Flemming v. Nestor,* the U.S. Supreme Court has ruled that Social Security taxes are simply taxes and convey no property or contractual rights to Social Security benefits.[48]

As a result, a worker's retirement security is entirely dependent on political decisions made by the president and Congress. Benefits may be reduced or even eliminated at any time and are not directly related to Social Security taxes paid into the system.

Therefore, retirees are left totally dependent on the whims of politicians for their retirement income. A person can work hard, play by the rules, and pay thousands of dollars in Social Security taxes but at retirement his benefits depend entirely on the decisions of the president and Congress. Despite their best intentions, seniors have been turned into little more than wards of the state.

Conclusion

If Social Security didn't exist today, would we invent it? The current Social Security system is a failure by almost every criterion. It fails to lift many seniors out of poverty or to improve prospects for future generations. Indeed, it may actually redistribute money from the poor to the wealthy. Because it forces the poor to annuitize their savings, it prevents the accumulation of real wealth and prevents the poor from passing that wealth on to future generations. Social Security also fails as a retirement program. It does not provide an adequate retirement income or yield the best possible return on an individual's money. Nor is the program fair. It includes numerous inequities that unfairly discriminate against minorities, the poor, and working women. And, finally, because people do not have any legal ownership of their benefits, it leaves seniors dependent on politicians and politics for their retirement benefits.

Surely this cannot be what we seek from Social Security, especially when there are alternatives available. Workers should be allowed to take the money they are currently paying in Social Security taxes and redirect it to individually owned, privately invested accounts, similar to individual retirement accounts or 401(k) plans. The funds that accumulated in those accounts would be invested in real assets such as stocks and bonds, with safeguards against highly risky or speculative investments. The funds would be the account holders' personal property. At retirement, workers could convert all or part of their accumulated funds into an annuity or take a series of programmed withdrawals from the principal. If they choose the latter option, any funds remaining at their death would become part of their estate, fully inheritable by their heirs.

A retirement program based on individually owned, privately invested accounts would provide higher retirement benefits and a better rate of return than does Social Security. It would lift more

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seniors out of poverty, and, because funds are inheritable, accumulated wealth could be passed on to future generations. It would not penalize groups with shorter life expectancies and would eliminate the penalty on working women. And workers would own their benefits and thus be free from political risk and dependence.[49]

When it comes to Social Security, policymakers should consider whether it is more important to save a system or to provide a better retirement for American seniors.

Notes

1. "Remarks by the President at Reception for the DCCC," White House. Office of the Press Secretary, M2 Presswire, April 4, 2000. Emphasis added.

2. "Gore Touts 'Fairer' Social Security," *Arizona Republic* April 5, 2000. Emphasis added.

3. Quoted in "Election 2000 on the Issues: National Debt," *Allentown (Pa.) Morning Call,* March 22, 2000. Emphasis added.

4. Quoted in Robert A. Rosenblatt and Alissa J. Rubin, "Economy Boosts Social Security Medicare Life; Benefits: Higher Tax Revenues Will Support Each for Longer Than Previously Thought. The New Solvency Changes the Political Debate for Both Parties," *Los Angeles Times* March 31, 2000. Emphasis added.

5. Board of Trustees, Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds, *2000 Annual Report* (Washington: Government Printing Office, 2000).

6. As President Clinton's own budget notes: "[Trust fund] balances are available to finance future benefit payments and other trust fund expenditures—but only in a bookkeeping sense. These funds are not set up to be pension funds like the funds of private pension plans. They do not consist of real economic assets that can be drawn down in the future to fund benefits. Instead, they are claims on the Treasury that, when redeemed, will have to be financed by raising taxes, borrowing from the public, or reducing benefits or other expenditures. The existence of large trust fund balances, therefore, does not, by itself, have any impact on the government's ability to pay benefits." Executive Office of the President of the United States, *Analytical Perspectives: Budget of the United States Government, Fiscal Year 2000* (Washington: Government Printing Office, 1999), p. 337.

7. "Ploys Will Be Ploys," Editorial, *Washington Post,* October 28, 1999.

8. W. Andrew Achenbaum, *Social Security: Visions and Revisions* (Cambridge: Cambridge University Press, 1986), pp. 54–55. See also Peter Ferrara, *Social Security: The Inherent Contradiction* (Washington: Cato Institute, 1980).

9. Bill Archer, Comments at Hearing on Social Security before the House Committee on Ways and Means, 106th Cong., 1st sess., June 9, 1999, transcript, p. 48, Federal News Service.

10. Daryl Jackson et al., "Understanding Social Security: The Issues and Alternatives," American Institute of Certified Public Accountants, Washington, November 1998, p. 17.

11. Bureau of the Census, Current Population Reports, Series P60, 1998.

12. Kathryn Porter, Kathy Larin, and Wendell Primus, "Social Security and Poverty among the Elderly: A National and State Perspective," Center on Budget and Policy Priorities, Washington, April 1999.

13. Ibid., p. 16.

14. Neil Gilbert and Neung-Hoo Park, "Privatization, Provision, and Targeting: Trends and Policy Implications for Social Security in the United States," *International Social Security Review* 49 (January 1996): 22.

15. Martin Feldstein and Anthony Pellechio, "Social Security and Household Wealth Accumulation: New Microeconomic Evidence," *Review of Economics and Statistics* 61 (August 1979): 361–68.

16. Dean Leimer and David Richardson, "Social Security, Uncertainty, Adjustments, and the Consumption Decision," *Economica* 59 (August 1992): 29.

17. Bureau of the Census, Current Population Reports, Series P60.

18. Steven Sandell, "Adequacy and Equity of Social Security," *Report of the 1994–1995 Advisory Council on Social Security* (Washington: Government Printing Office, 1997), vol. 2, pp. 321–27.

19. Bureau of the Census, Population Report P60-175, 1996, Table 6, p. 18.

20. Assumes investment in stocks earning actual returns and that the individual was born in 1935, earned the minimum wage his entire working life, and retires in 2000.

21. Survivors' benefits may be extended to age 21 if the child is enrolled in college.

22. Jagadeesh Gokhale et al., "Simulating the Transmission of Wealth Inequality via Bequests," *Journal of Public Economics* (forthcoming, 2000).

23. Jagadeesh Gokhale and Laurence Kotlikoff, "The Impact of Social Security and Other Factors on the Distribution of Wealth," National Bureau of Economic Research, Cambridge, Mass., October 1999.

24. Martin Feldstein, "Social Security and the Distribution of Wealth," *Journal of the American Statistical Association* 71 (December 1976): 800–807.

25. Quoted in Warren Shore, *Social Security: The Fraud in Your Future* (New York: Macmillan, 1975), p. 2.

26. Barbara Bovbjerg, "Social Security: Issues in

Comparing Rates of Return with Market Investments," U.S. General Accounting Office Report HEHS–99–110, August 1999.

27. Dean Leimer, "Cohort-Specific Measures of Lifetime Net Social Security Transfers," Social Security Administration, Office of Research and Statistics, Working Paper no. 59, February 1994.

28. For example, in our 1998 book, *A New Deal for Social Security,* Peter Ferrara and I updated a study that Ferrara conducted for the National Chamber Foundation in 1986. Using economic and demographic assumptions taken from the Social Security trustees' intermediate assumptions, adjusting for survivors' and disability benefits, and assuming that, somehow, Social Security would pay all promised benefits, we found that most workers who entered the workforce after 1985 would receive rates of return of 1.0 to 1.5 percent or less. Peter J. Ferrara and Michael Tanner, *A New Deal for Social Security* (Washington: Cato Institute, 1998), p. 69. Those results closely matched the results of a study that Ferrara conducted in 1985 with Professor John Lott, then at the Wharton School and now at Yale Law School. The 1985 study, which looked at workers entering the workforce in 1983, also showed rates of return from Social Security for most workers in the range of 1.0 to 1.5 percent. Peter J. Ferrara and John Lott, "Social Security's Rates of Return for Young Workers," in *Social Security: Prospects for Real Reform,* ed. Peter Ferrara (Washington: Cato Institute, 1985), pp. 13–36. The Heritage Foundation concluded in 1998 that the rate of return to an average two-earner family (both 30 years old) was just 1.23 percent, while the return to African American men was actually negative. William Beach and Gareth Davis, "Social Security's Rate of Return," Report no. 98-01 of the Heritage Center for Data Analysis, Washington, January 15, 1998. In a 1988 study for the National Bureau of Economic Research, John Geanakopolis, Olivia Mitchell, and Stephen Zeldes concluded that workers born after 1970 could expect a rate of return of less than 2 percent. John Geanakopolis, Olivia Mitchell, and Stephen Zeldes, "Social Security's Money Worth," National Bureau of Economic Research Working Paper no. 6722, Washington, September 1988. The U.S. General Accounting Office reports that a two-earner couple born in 1973 and making average wages would receive a rate of return from Social Security of approximately 2.1 percent. Bovbjerg, p. 13. The nonpartisan Tax Foundation suggests future rates of return as low as a negative 3 percent. Arthur Hall, "Forcing a Bad Investment on Retiring Americans," Tax Foundation Special Report no. 55, November 1995.

29. See, for example, Jagadeesh Gokhale and Laurence Kotlikoff, "Social Security's Treatment of Postwar Americans: How Bad Can It Get?" National Bureau of Economic Research Working Paper no. 7362, Cambridge, Mass., September 1999. See also Hall; Beach and Davis; and Geanakopolis, Mitchell, and Zeldes.

30. Gokhale and Kotlikoff, "Social Security's Treatment of Postwar Americans," p. 15.

31. Jeremy J. Siegel, *Stocks for the Long Run* (New York: McGraw-Hill, 1998), p. 26. Of course, critics of privatization point out, correctly, that the past is no guarantee of future performance. But the critics' contention that the future performance of private capital markets will be significantly lower than past averages is unpersuasive. See, for example, Peter Ferrara, "Social Security Is Still a Hopelessly Bad Deal for Today's Workers," Cato Institute Social Security Paper no. 18, November 29, 1999.

The critics generally argue that, using the Social Security trustees' projections for future economic growth, economic growth will be too slow to sustain continued stock market gains. Dean Baker and Mark Weisbrot, for example, suggest that future returns will be below 3.5 percent. Dean Baker and Mark Weisbrot, *Social Security: The Phony Crisis* (Chicago: University of Chicago Press, 1999), pp. 88–104. However, the critics fail to acknowledge that the issue is not simply the return to capital markets but the spread between the return to capital markets and the return to Social Security. As Gokhale and Kotlikoff point out, Social Security tax payments and benefit receipts are closely linked to overall labor productivity growth, which is highly correlated with economic performance, which, in turn, is correlated with stock market performance. It is entirely reasonable to compare the real rate of return from stocks with the return from Social Security. Gokhale and Kotlikoff, "Social Security's Treatment of Postwar Americans," p. 15. In other words, if economic growth is so slow as to reduce the returns from private capital investment, it will also reduce the taxes collected by the Social Security system, exacerbating its fiscal imbalance, leading to lower benefits or higher taxes and a reduced Social Security rate of return. Thus, both Social Security's return and the return on capital could go up or they could go down, but private capital markets will always outperform Social Security. It is even possible to envision a scenario in which capital returns increase while Social Security tax receipts do not, for example, if wage growth takes place largely above the cap, or if economic growth translates to nonwage compensation rather than increased real wages. However, it is difficult to foresee a scenario under which real wages (and therefore Social Security revenues) rise while private capital markets do not.

Critics of privatization also suggest that the return to private capital markets should be reduced to reflect administrative costs and the costs associated with the transition to a privatized system. Both arguments have been refuted extensively elsewhere. However, it is worth noting that the U.S. General Accounting Office suggests that administrative costs would range from a low of 10 basis points to a high of 300 basis points, with most estimates closer to the low end of the range. U.S. General Accounting Office, "Social Security Reform: Administrative Costs for Individual Accounts Depends on System Design," GAO/HEHS-99-131, June 1999. A study for the Cato Institute concluded that administrative costs would range between 30 and 65 basis points. Robert Genetski, "Administrative Costs and the Relative Efficiency of Public and Private Social Security Systems," Cato Institute Social Security Paper no. 15, March 9, 1999.

The question of transition costs is also highly misleading. First, it has been clearly demonstrated that it is possible to pay for the transition without additional taxes. See, for example, Ferrara and Tanner, pp. 175–204. Even more important, however, Milton Friedman and others have shown that, when Social Security's current unfunded lia-

bilities are considered, there are no new costs associated with the transition. Milton Friedman, "Speaking the Truth about Social Security Reform," Cato Institute Briefing Paper no. 46, April 12, 1999. Indeed, as William Shipman has demonstrated, the cost of paying for the transition, regardless of the financing mechanism chosen, will always be less than the cost of preserving the current system. William Shipman, "Facts and Fantasies about Transition Costs," Cato Institute Social Security Paper no.13, October 13, 1998.

32. Calculated from Moody's Investor Service, *Moody's Industrial Manual* and *Moody's Bond Survey,* 1920–96.

33. Assumes husband retires at age 67, husband collects full Social Security benefit, and wife collects spousal benefit until husband dies at age 75. Wife then collects widow's benefit until she dies at age 81.

34. Assuming historical rates of return.

35. A. Haeworth Robertson, *Social Security: What Every Taxpayer Should Know* (Washington: Retirement Policy Institute, 1992), p. 218.

36. David Koitz, "Social Security Reform: Assessing Changes to Future Retirement Benefits," Congressional Research Service Report for Congress RL-30380, December 14, 1999.

37. Daniel Shapiro, "The Moral Case for Social Security Privatization," Cato Institute Social Security Paper no. 14, October 29, 1998.

38. Social Security benefits are based on a formula that provides benefits equal to 90 percent of the first $495 of monthly income (adjusted according to a formula that takes into account the growth in wages), 32 percent of the next $2,286, and 15 percent of remaining income up to the wage cap.

39. See C. Eugene Steuerle and John Bakija, *Retooling Social Security for the 21st Century: Right and Wrong Approaches to Reform* (Washington: Urban Institute, 1994), pp. 91–132; and Dean Leimer, "Lifetime Redistribution under the Social Security Program: A Literature Synopsis," *Social Security Bulletin* 62 (1999): 43–51.

40. Daniel Garrett, "The Effects of Differential Mortality Rates on the Progressivity of Social Security," *Economic Inquiry* 33 (July 1995): 457–75; W. Constantijn, A. Panis, and Lee Lillard, "Socioeconomic Differentials in the Return to Social Security," RAND Corporation Working Paper no. 96-05, February 1996; and Beach and Davis.

41. Counting only the OASI portion of the payroll tax. This figure does not include the disability portion.

42. Bureau of the Census, *Statistical Abstract of the United States, 1995* (Washington: Government Printing Office, 1996), Table B-1.

43. Ibid.

44. Projected life expectancy at age 30. Centers for Disease Control, "United States Abridged Life Tables, 1996," *National Vital Statistics Report,* no 13 (December 24, 1998): Table 3.

45. Supporters of the current system maintain that, overall, African Americans benefit from the current Social Security system because they earn lower incomes than whites and are more likely to have periods of unemployment. Therefore, they are more likely to benefit from the program's progressive benefit formula. However, as we have seen, the lifetime progressivity of Social Security is questionable. Supporters of the status quo also suggest that Africa Americans benefit disproportionately from the program's disability and survivors' benefits. However, there are no empirical studies to support that contention. Indeed, the Social Security Administration rejected a request from the 1996–98 Social Security Advisory Council to conduct such a study. Sylvester Schieber and John Shoven, *The Real Deal: The History and Future of Social Security* (New Haven, Conn.: Yale University Press, 1999), p. 227.

46. The provision is gender neutral, applying to both men and women. However, because of earning patterns in the United States, it affects women almost exclusively.

47. For a full discussion of the impact of the current Social Security system on women and the benefits of privatization for women, see Darcy Ann Olsen, "Greater Financial Security for Women with Personal Retirement Accounts," Cato Institute Briefing Paper no. 38, July 20, 1998; and Ekaterina Shirley and Peter Spiegler, "The Benefits of Social Security Privatization for Women," Cato Institute Social Security Paper no. 12, July 20, 1998.

48. For a thorough discussion of this issue, see Charles Rounds, "Property Rights: The Hidden Issue of Social Security Reform," Cato Institute Social Security Paper no. 19 April 19, 2000.

49. For a full discussion of how a privatized Social Security system would work, see Ferrara and Tanner.