



Center for Policy Analysis and Research



The Social Security Privatization Crisis:

Assessing the Impact on African American Families

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EXECUTIVE SUMMARY

For years, proponents of individual accounts have argued that African Americans can make up for centuries of discrimination and disadvantage by investing a portion or all of their Social Security payroll contributions in the stock market.

Despite the lure of these arguments, African Americans, policymakers, and the general public must take care to understand the importance of Social Security to African American families and how they would be affected if the system were partially privatized.

- **Social Security is a comprehensive family insurance program that is extremely important for African American families who heavily rely on its survivor, disability and retirement benefits.** African American children are especially reliant on Social Security's steady benefits comprising 20 percent of all retired worker child beneficiaries, 23 percent of all child survivor beneficiaries, and 21 percent of all disabled worker child recipients.
- **Deep cuts in Social Security's steady benefits, like those proposed in Model 2 of the President's Social Security Commission, are a threat to African American families who would be most likely to face extreme poverty in the event that revenue from individual accounts are insufficient to cover the costs of retirement, disability, or survivor benefits.** Young African American workers who experience early disability or death would not have enough accumulated in their individual accounts to cover the amount of the cuts. Black children and widow(er)s are likely to suffer the most.
- **Arguments that African Americans would receive great wealth from individual accounts are misleading and overlook the fact that existing racial income disparities would remain or even widen under individual accounts even if blacks and whites were earning the same rate of return.** African Americans, who have lower earnings and higher rates of unemployment, would be severely disadvantaged by the elimination of a real progressive benefit structure in a system of individual accounts.

This critical analysis provides an overview of the likely impact of individual accounts on African American families and should serve as a guidepost to policymakers seeking to enact reforms in Social Security.

"Equality means dignity. And dignity demands a job and a paycheck that lasts through the week."
— 1963, Martin Luther King, Jr.

"The dignity of the individual will flourish...when he has the assurance that his income is stable and certain, and when he knows that he has the means to seek self-improvement."
—1963, Martin Luther King, Jr.

INTRODUCTION

For over a half-century, the Old Age, Survivors and Disability Insurance (OASDI) program—more commonly known as Social Security—has protected American families from falling into poverty because of the loss of income due to retirement, death of a breadwinner, or disability. As the most important source of income for more than 80 percent of elderly Americans and virtually the only source of income for the poorest 40 percent of older Americans, Social Security provides people with a guaranteed, inflation-adjusted retirement income for a lifetime. As such, many consider it one of the most successful programs in the history of the United States.

Some who are critical of Social Security have promoted the idea of diverting a portion of the Social Security payroll tax to fund individual retirement accounts. In an attempt to win support from racial and ethnic minorities, these privatization advocates have crafted arguments to convince these groups that they can make up for centuries of discrimination and disadvantage by investing their hard earned Social Security contributions in private equities where they can earn inheritable wealth through the “magic” of compound interest. This report assesses the veracity of these arguments and concludes that they severely underestimate the impact of privatization on African American families while overlooking the full range of Social Security program benefits that are important to these same families.

SOCIAL SECURITY & AFRICAN AMERICANS

Popularly perceived as just a retirement plan, Social Security is actually a comprehensive family insurance plan that provides critical support for the families of retired, deceased and disabled workers. The full range of Social Security benefits are very important to African American families due to the nature of their social and economic evolution in the United States.

Historical patterns of racial discrimination in the U.S. and the adverse impact of certain public policies have affected African Americans in the key areas of education, labor, and health. As a result, African Americans are more likely to earn a modest living during the course of their working lives, more likely to have experienced spells of unemployment or underemployment, more likely to retire with less income from private pensions, assets or personal savings, and more likely to experience disability or early death. These factors severely disadvantage African Americans and greatly influence how they relate to the Social Security program.

Percent of Americans receiving OASDI, by type of benefit and race

Figure 1 Blacks

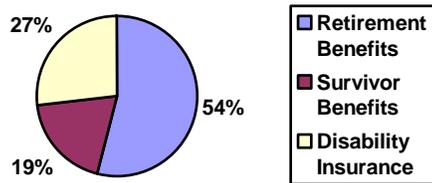
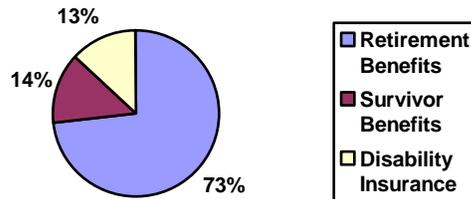


Figure 2 Whites



Social Security Administration, Annual Statistical Supplement 2003, Table 5.A1, "Number and average monthly benefit, by type of benefit and race, December 2002."

While comprising 12 percent of the U.S. population, African Americans were 8 percent of all retired beneficiaries, 13 percent of all survivor beneficiaries, and 18 percent of all disability recipients in 2002.¹ Social Security Administration figures illustrate that African American families have a different relationship than whites to the range of benefits offered through OASDI; having greater reliance on Social Security's Survivor and Disability benefits.

Social Security's comprehensive family insurance structure is particularly important for African American children who are 20 percent of all retired worker child beneficiaries, 23 percent of all child survivor beneficiaries, and 21 percent of all disabled worker child recipients.² Social Security's benefits are especially important for the children of

¹ Social Security Administration, Annual Statistical Supplement, 2003, Table 5.A1, "Number and average monthly benefit, by type of benefit and race, December 2002."

² Ibid.

deceased workers who are 48 percent of all African Americans receiving survivor benefits.³ In contrast, 72 percent of whites receiving survivor benefits are widow(er)s, (compared to 44 percent of blacks) and only 23 percent are the children of deceased workers.⁴ Of African Americans receiving disability benefits 25 percent are children compared to 20 percent of whites.⁵

Overall, African Americans were 10.3 percent of all Social Security recipients in December 2002 (there were 4,784,360 African Americans out of 46,452,550 total OASDI recipients).⁶

Social Security’s benefits are extremely important source of economic support for African American families who experience the crisis of disability or unexpected death. An estimated 68 percent of disabled African Americans are kept out of poverty by Social Security’s disability benefits.⁷ Additionally, a 1999 study by the National Urban League Institute for Opportunity and Equality estimated that African American children are almost four times more likely to be lifted out of poverty by Social Security survivor benefits than are white children.⁸

Social Security’s Share of Income for African Americans Aged 65 or older

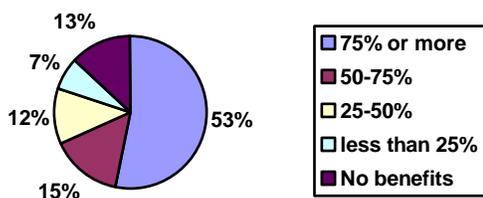


Figure 3 Blacks

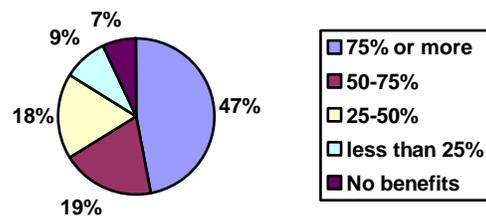


Figure 4 Whites

Social Security Administration, Annual Statistical Supplement, 2003, Table 3.E6 “Percentage distribution of aged families receiving Social Security benefits, by share of income from benefits and race, 2001.”

And, even though a greater proportion of whites rely on Social Security’s retirement benefits than do blacks, these benefits remain extremely important for African American retirees, who tend to have lower pre-retirement earnings (a primary factor in benefit calculations) and less pension coverage than white Americans. As a result, Social Security is the only source of retirement income for 40 percent of older African

³ Ibid.

⁴ Ibid.

⁵ Ibid.

⁶ Ibid.

⁷ Social Security Administration , Fast Facts & Figures About Social Security, 2001.

⁸ Valerie Rawlston, “The Impact of Social Security on Child Poverty,” A special report issued by the National Urban League Research and Public Policy Department, May, 2000.

Americans.⁹ And, without Social Security the Social Security Administration estimates the poverty rate for African American seniors would more than double.¹⁰

African Americans, who are disproportionately lower income workers, also benefit from Social Security's progressive benefit structure, which replaces a larger percentage of low-income beneficiaries pre-retirement earnings as compared to higher income beneficiaries. Combined with an annual cost of living adjustment that keeps Social Security benefits on par with inflation, the value of Social Security's steady and stable benefits are great for African American families.

SOCIAL SECURITY PRIVATIZATION & AFRICAN AMERICAN FAMILIES

While the specifics of the Administration's proposal to implement individual accounts have yet to be fully defined, there are strong indications that it is considering elements of Model 2 established by the President's Social Security Commission. In this scenario, 4 percentage points of an individual's Social Security payroll taxes (up to an annual maximum amount) are diverted from the trust fund to create private individual accounts. To cover the gap in Social Security funding created by this diversion, Social Security benefit calculations would be adjusted to reduce the amount of guaranteed benefits provided over time by indexing benefits to price inflation instead of wages.¹¹

Estimates issued by the Congressional Budget Office and reported by the Center on Budget and Policy Priorities found that under Plan 2 benefits for a typical median wage earner born in the 1970s and retiring at age 65 would be reduced by 23 percent as compared to benefits promised by current law.¹² For the same type of earner born in the 1990s and retiring at age 65, the cuts would be 38 percent compared to current law.¹³ Indeed, CBO found that Plan 2 benefits for this earner would be 20 percent lower than benefits would be *even if policymakers did nothing to close the long-term Social Security shortfall*.¹⁴

Since the diversion of payroll taxes from the Social Security trust fund to finance individual accounts is a common feature of most privatization plans, deep cuts in guaranteed retirement, survivors, and disability benefits are likely under most proposals. However, the highly misleading nature of arguments put forth by privatization advocates obscure the likely effects of these cuts on African Americans and other vulnerable

⁹ Social Security Administration, "Press Office Fact Sheets: African Americans and Social Security," September, 2004.

¹⁰ AARP, "African Americans Age 65 and Older: Their Sources of Income," September 2004 (based on March 2003 Current Population Survey, U.S. Census Bureau).

¹¹ The President's Commission to Strengthen Social Security, "Strengthening Social Security and Creating Personal Wealth for all Americans," Final Report of the President's Commission, December 2001.

¹² Robert Greenstein, "So Called Price Indexing Proposal Would Result in Deeper Reductions Over Time in Social Security Benefits

¹³ Ibid.

¹⁴ Ibid.

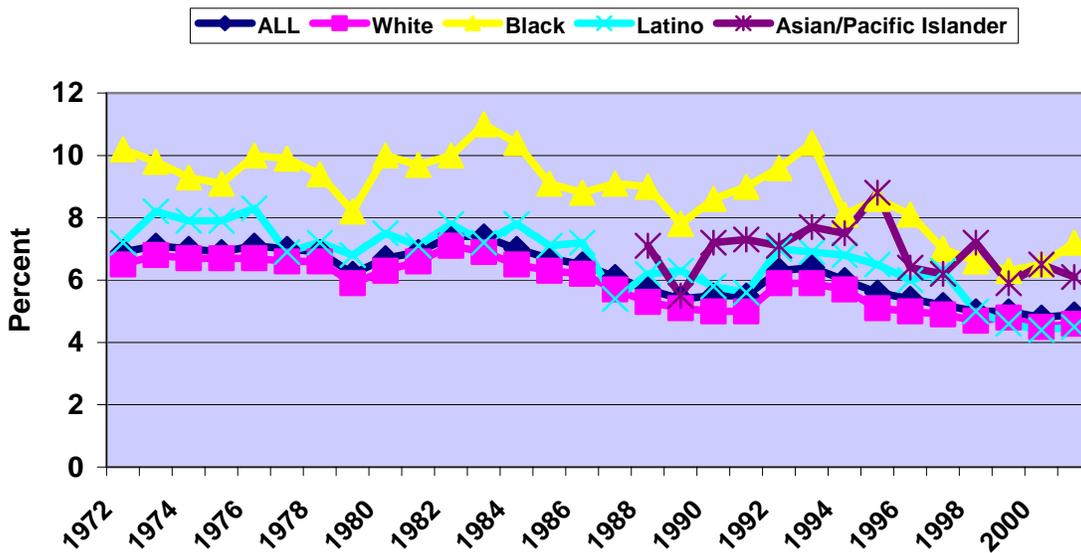
populations. Benefit cuts and the increased risk that accompany individual accounts are a significant threat to African American families who heavily rely on all three aspects of Social Security.

The Interaction Between Earnings, Work History, and Individual Accounts

It is commonly understood that African Americans have a different relationship to the labor market than do whites. For more than a century blacks have experienced income disparities that result in their lower lifetime earnings. To illustrate the persistence of this phenomenon, African Americans had a real median income of \$29,600 compared to \$47,800 for whites in 2003.¹⁵ There are similar disparities in African American unemployment rates. For example, the African American unemployment rate was 10.5 percent in 2004 compared to only 4.3 percent for whites.¹⁶ These disparities also carry over into the length of time unemployed with 48 percent of unemployed African Americans out of work for more than 15 weeks in 2004 compared to 34 percent of whites.¹⁷

Figure 5

Percent of Men Earning \$2,499 or Less



Source: U.S. Census Bureau, 2001

The effects of earnings and unemployment disparities have a significant impact on African American men and women. These differences are graphically reflected in the

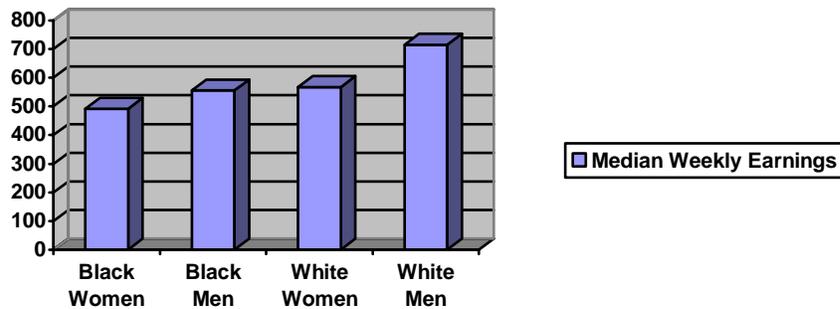
¹⁵ U.S. Census Bureau, “Income, Poverty, and Health Insurance Coverage in the United States: 2003”, Chart 5, Current Population Survey, 2003 and 2004 Annual Social and Economic Supplements.

¹⁶ Bureau of Labor Statistics, Table D-16, “Unemployment rates by age, sex, race, and Hispanic or Latino ethnicity.”

¹⁷ Bureau of Labor Statistics, Table D-18, “Unemployed Persons by duration of unemployment, race, and Hispanic or Latino ethnicity.” (Not seasonally adjusted).

case of black men who are more likely than white men to have years of little or zero earnings.¹⁸ Within race, African American men have higher unemployment rates (10.7 percent versus 9.1 percent in December 2004) but earn slightly more than black women. Black women, having lower earnings than black men and higher unemployment rates than white women, are also affected by these disparities.

Figure 6
Median Weekly Earnings by Race and Gender, 2003



Bureau of Labor Statistics, “Median weekly earnings of full-time wage and salary workers by selected characteristics,” Household Data Annual Averages, Table 37.

Given these realities, the structure of individual accounts would do little to offset the racial and gender inequities in earnings and unemployment. Indeed, the benefit projections in Model 2 fail to account for racial disparities in the labor market where African Americans would be disadvantaged by periods of very small or zero contributions to their individual accounts due to unemployment. When these periods are factored in, racial (and gender) disparities in the value of individual accounts would remain (and perhaps widen) *even if blacks and whites were earning the same rate of return*. During times of economic recession, the impact of this phenomenon would be particularly great.

Model 2 of the President’s Commission claims to offer a progressive-like benefit for low-wage workers by allowing them to contribute 4 percentage points of their payroll taxes up to the entire amount of their earnings (as opposed to higher earners who would have a cap of \$1,000). Yet, Model 2’s claim to progressivity is also misleading. Whereas Social Security’s retirement benefit makes up for differences in earnings levels and years out of the workforce through the provision of a progressive benefit formula that replaces a higher percentage of pre-retirement earnings while taking into account the 35 highest years of earnings (and dropping the lowest years), Model 2’s individual accounts do not provide this help. Instead, the plan claims to offer a higher benefit to low-income individuals by allowing them to contribute more of their earnings to individual accounts.

¹⁸ Bureau of Labor Statistics, Table A-4, “Employment Status of the civilian noninstitutional population by race, sex, age, and Hispanic or Latino ethnicity (seasonally adjusted).”

In reality, this proposal places African Americans and other low-income earners in peril by increasing their risk of being overexposed to the stock market while decreasing their certainty that they will receive adequate income from their investments to cover their retirement needs. When the cuts in Social Security’s guaranteed benefits created by Model 2’s “price indexing” are added to the equation, African American families would end up significantly behind, not ahead, in their quest for retirement security.

Savings, Investment, and Risk

Proponents of individual accounts often point to the lack of “inheritable wealth” provided by Social Security as another reason why African Americans should support privatization. It is a well documented that African Americans are less likely than whites to have assets of value. In fact, whites had more than six times as much wealth as African Americans in 2001.¹⁹ A 2000 survey of current retirees found that about 65% percent of whites received income from private assets as compared to 28 percent of African Americans.²⁰ Whites were also more likely to have income from private pensions (45 percent versus 33 percent).²¹

Income Sources Upon Retirement By Race
 (Income of the Population 55 and Older, 2000
 Social Security Administration, Table 1.3)



Figure 7

Despite compelling evidence pointing to other reasons for the racial wealth gap, many reform proponents suggest a causal relationship between the payroll tax (also known as the Federal Insurance Contribution Act or “FICA” tax), which funds Social Security, and

¹⁹ Arthur B. Kennickell, “A Rolling Tide: Changes in the Distribution of Wealth in the U.S., 1989-2001,” Federal Reserve Board, March 2003.

²⁰ Social Security Administration, Table 1.4, “Income of the Population 55 and Older, 2000.”

²¹ Ibid.

racial disparities in wealth.²² They argue that payroll contributions to Social Security prevent African Americans from directing this revenue toward savings.²³ Redirecting this payroll tax toward private accounts would, in their estimation, provide more favorable circumstances for African Americans because they could invest in the private market where they would presumably accrue substantial value that could either be bequeathed to heirs and/or used to purchase an annuity upon retirement.

Sadly, many African American families do suffer from a lack of personal assets that can supplement their income upon retirement. This lack of private wealth, however, is not due to the Social Security payroll tax but to the historic marginalization of African Americans in a labor market where they have been disproportionately unemployed, underemployed, and/or segmented into those jobs that do not offer pension benefits.²⁴ The result is their overrepresentation among low and moderate income workers and the diminished capacity to accumulate, purchase or “pass on” assets such as equity-rich homes, stocks, land, or a cash inheritance.

Given the racial wealth disparities that exist, it is important for policymakers to consider ways to close this asset gap. Social investment in savings vehicles like Individual Development Accounts, “Universal 401K’s” and other such measures would provide a positive benefit for African American families that experience obstacles to asset accumulation. These asset-building measures, however, should be pursued as a supplement to, not at the expense of, Social Security’s important benefits. A “carve out” approach like those proposed by the President’s Social Security Commission would undermine one of a few existing programs that brings some balance to racial inequities in the labor market and would likely leave African Americans in even worse shape.

This is true for several reasons. First, the stock market’s notorious fluctuations cannot guarantee the long-term growth of amounts contributed to individual accounts. A carve-out approach would increase the risk of retirement *insecurity* for African Americans because, as discussed above, it would deeply reduce the guaranteed benefits of the current system at the same time it is exposing them to greater risk in the private markets. Thus, there is a real risk of extreme poverty for African American seniors on a fixed income if expected gains are not realized. This level of risk is unacceptable and ill advised.

²² Jagadeesh Gokhale, “The Impact of Social Security Reform on Low Income Workers,” Cato SSP No. 23, December 2001.

²³ Ibid.

²⁴ Given the fact that many current African American retirees are only the second and third generations away from their slave ancestors (who were forbidden to own property or obtain an education that could have improved their economic circumstances) and only zero to one generations away from de-jure segregation (which also systematically limited economic and educational opportunities for blacks), it is perhaps not surprising that this population has yet to accumulate substantial personal wealth that is inheritable across generations. Yet those examining the wealth gap often overlook historical factors when attempting to establish reasons for its existence.

Precisely because African Americans tend to be among the low-income, it is especially important that they have a steady, affordable, inflation-adjusted Social Security benefit to rely on in the face of an uncertain stock market.

The inheritable wealth argument presents another reason for African Americans to be extremely cautious. Currently, Social Security provides survivor benefits for the dependents of a worker who passes away in the prime of his or her working years. Because blacks have lower life expectancies, African American widow(er)s and/or surviving children disproportionately rely on these benefits when compared to whites. Survivor benefits are particularly important to young African American children who receive economic support until they reach the age of 18.

However, under a system of individual accounts, an African American male dying in his thirties is unlikely to have enough funds accumulated in his individual account to offset the deep cuts in Social Security benefits that accompany these accounts.²⁵ As a result, young child survivors, who are the least able to fend for themselves, would be likely to have less financial support than that offered by current law. Thus, young black children, a significant number of whom live in poverty, would be severely disadvantaged by efforts to privatize Social Security.

If promises of providing an “inheritance” to the heirs of African Americans who pass away before they access retirement benefits does not apply to young child survivors then who are privatization supporters referring to when they make these claims? Proponents typically cite the case of an older (say 57 years old) African American male who dies before he is able to receive retirement benefits. In this scenario, whatever funds this individual was able to accrue in his individual account would likely go to adult surviving children—who are better able than younger surviving children to take care of themselves when a parent passes away.

Furthermore, individuals reaching the age of retirement who want to leave an inheritance would likely be required to use their account funds to purchase an annuity with a life insurance feature that could be paid out to survivors upon death. This type of policy would be very expensive and would expose the retiree to the risk of having very little money to live on in retirement and his heirs with little or next to nothing.

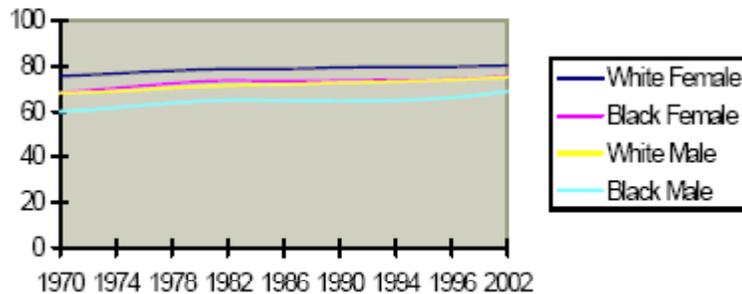
A final consideration that is counter to the arguments offered by those who claim Social Security payroll taxes crowd out African American’s ability to save is the fact that individuals would still need to purchase life and disability insurance and an annuity if Social Security’s benefits were greatly reduced or phased out. Yet, purchasing insurance policies that cover the range of benefits provided by Social Security would be more expensive in the private market and African American families would run the risk of being underinsured if they are unable to secure this coverage. Thus, Social Security’s life insurance, disability insurance, and annuity features are a value for African American

²⁵ Valerie Rawlston and William Spriggs. “Social Security: A True Family Value,” This paper was published as a chapter in the Fall 2001 IRRA research volume entitled, *The Future of the Safety Net: Social Insurance and Employee Benefits*.

families who would likely be less able to afford this coverage were it not for their 6.2 percent payroll tax contribution.

Life expectancy and rates of return

Life Expectancy at Birth by Race and Sex, 1970-2002
(National Vital Statistics Reports, Vol. 53, No. 6, Nov. 10, 2004)



Those who favor individual accounts say that Social Security gives African Americans a lower rate of return because of their higher mortality rates. Indeed, African Americans do have shorter life expectancies. The National Center on Health Statistics reports that African Americans can expect to live 72.3 years compared to the 77.7 years for whites.²⁶ At birth, black men have a lower life expectancy than white men, white women, and African American women.

While it is true that African American men die at younger ages, they usually die at dramatically younger ages—not at or just prior to retirement as some suggest. What privatization proponents do not explain is that when black and white men reach the age of 65, the actual difference in their life expectancy has decreased to two years.²⁷ And because of African American men are slightly more likely to draw an early retirement at the age of 62, the difference in the number of years that black and white men receive benefits is further reduced to less than two years.

Shorter life expectancies notwithstanding, those who claim that African Americans receive a lower rate of return present a false view of the value of Social Security’s comprehensive benefits to black families by considering only the retirement portion of the program at the exclusion of survivor and disability benefits.

As discussed previously, Social Security helps African Americans mitigate the negative economic impact resulting from their higher rates of disability and early death through Social Security’s disability and survivor benefits, which provides critical economic assistance for the families of African Americans who become disabled or die in the prime

²⁶ National Center for Health Statistics, “Life Expectancy at birth, at 65 years of age, and at 75 years of age, according to race and sex: United States, selected years 1900-2002.” Table 27.

²⁷ Ibid.

of their working lives. A 2003 study by the General Accounting Office found that overall African Americans receive a *higher rate of return*—receiving more in benefits than what is paid out in payroll taxes—than whites due to their heavier reliance on the full range of benefits offered by Social Security.²⁸

Finally, privatization advocates fail to make it clear to the public that funding private retirement accounts by diverting money away from the current system would also undermine the economic viability of the survivor and disability components of the Social Security system (this is so because payroll taxes are pooled into one OASDI trust fund that covers retirement, disability and survivor benefits). Given this fact, it would be unlikely that policymakers can meet promises to preserve the current level of survivor and disability benefits in the event that private accounts are implemented.

It is perhaps ironic that prominent privatization advocates highlight the problem of higher mortality rates in the African American community as a justification for supporting individual accounts, while proposing to increase the retirement age along with implementing individual accounts. Instead of including structural features in the accounts to make it easier for African American men to access retirement benefits, they propose to raise the bar.

CONCLUSION

Overall, African Americans would be adversely affected by efforts to implement private individual accounts due to deep cuts in Social Security’s guaranteed benefits, increased exposure to stock market risk, and the elimination of real a progress benefit and cost of living adjustments within individual accounts. Given the structure of the proposals being considered, it is highly likely that African Americans—who are disproportionately low and moderate-income earners—would run the risk of living in extreme poverty upon retirement. African American families that experience the trauma of early disability or death would also face this same risk due to the inability of individual accounts to make up for deep cuts in Social Security’s stable benefits.

While it is certainly valid to promote the need for wealth creation strategies for African Americans and other economically disadvantaged communities, it is disingenuous at best to argue that carving out a portion of Social Security to do so is the best way to accomplish this goal. Socially responsible policy experts must focus on devising asset development proposals that can supplement Social Security’s guaranteed foundation of financial support. And, while Social Security could use some adjustments to correct its long-term fiscal imbalance of 20 cents on every dollar in the year 2052, there are certainly more responsible ways for securing the system for generations to come.

In the upcoming debate on whether to privatize the system, policymakers must explore financing options without using misleading racial arguments to undermine the principles

²⁸ General Accounting Office (GAO-03-387), “Social Security and Minorities: Earnings, Disability Incidence, and Mortality Are Key Factors that Influence Taxes Paid and Benefits Received,” April 2003.

that have made Social Security a vital source of income support for generations of African Americans.