ECONOMIC OPPORTUNITY INSTITUTE

Social Security UPDATE

By
Marilyn P. Watkins, Ph.D.
Policy Director

Investing in Our Children's Education, Not Privatization, Will Secure Social Security

A look at the 2005 Trustees' Report and a Plan for the Future

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Social Security has been a great success for seven decades. The 2005 Trustees' Report confirms that the program can easily continue to provide economic security to all Americans through the 21st century.[1]

Social Security guarantees that all workers and their family members can live in dignity when they can no longer work because of old age, disability, or death. Before Social Security, most seniors faced the prospect of dire poverty in their final years. Moving in with their children was the only safety net. Today 90% of seniors are free from poverty, and most are able to live independently. Social Security also sustains millions of disabled workers and children. In fact, more children live in households supported by Social Security (5 million) than Temporary Assistance to Needy Families, or welfare (4 million).[2]

Privatizing Social Security as President Bush has proposed will slash guaranteed benefits for everyone, remove the foundation of economic security from seniors and families who have experienced tragedy, and cost American taxpayers trillions of dollars. Rather than dismantling a successful program, we should focus our efforts on strengthening the American economy and increasing the productivity of the future workforce. Investing now in the education of our children and young adults will pay double dividends by providing opportunity for a prosperous future to younger generations and by securing Social Security's long-term finances.

Social Security Finances: Understanding the Trustees' Report

The Social Security Trustees' 2005 Annual Report confirms that the program remains financially sound, despite politically motivated efforts to undermine public confidence. Every year the Trustees,

E O I
Economic Opportunity Institute
1900 N. Northlake Way
Suite 237
Seattle, WA 98103
www. eoionline.org

who include the Secretaries of Labor, Treasury, and Health and Human Services, the Social Security Commissioner, and two presidential appointees, project Social Security finances 75 years into the future. Because long-term forecasts are speculative, the Trustees make three different projections. The projections require numerous assumptions about birth rates, immigration rates, unemployment, average wages, and the like. Over 75 years, small differences in assumptions can result in large differences in outcomes. The Trustees make three different projections based on different assumptions. These three scenarios are called the low-cost (most optimistic), intermediate, and high-cost (least optimistic) projections.

The low-cost projection shows the system fully funded for 75 years and beyond. The intermediate estimate, the one usually cited in public reports, and the high-cost estimate both project that in several decades the system will have funds for only partial benefits unless changes are made.

Social Security is primarily a pay-as-you-go system. Workers and their employers pay payroll taxes that fund current benefits.

Outlook for the next 35 years

- Since 1983, American workers have paid higher payroll taxes than needed to cover benefit costs. The extra money has been building up the Social Security trust fund in preparation for the bulge in program costs when baby boomers retire.
- In 2004, Social Security took in $156 billion more than it spent.
- The trust fund held nearly $1.8 trillion in assets at the end of 2004 and earned $89 billion in interest that year.
- According to the 2005 intermediate forecast, payroll taxes will continue to exceed benefits until at least 2017.
- All Social Security income (including interest and the income taxes that some higher income seniors pay on benefits) will exceed benefits until 2027. After that year, the program would begin to cash in the Treasury bonds held by the trust fund.

What happens after 2041

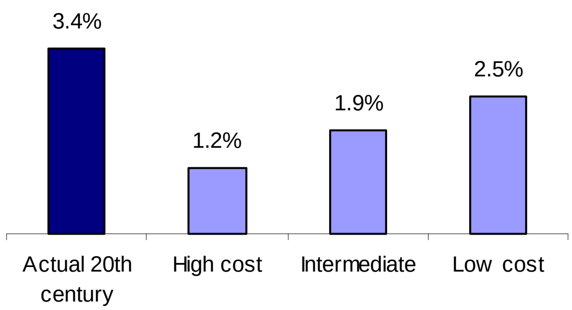
- In 2041, the trust fund would be depleted, according to the intermediate scenario; however the 12.4% payroll tax rate would cover 74% of promised benefits. These dates have been moved forward one year from the 2004 report because job growth and wage increases have been lower than anticipated in the wake of the 2001 recession, and because life expectancies have gone up slightly.
- According to the less pessimistic low-cost forecast, the trust fund will never be exhausted, and Social Security will have the resources to cover full promised benefits through the 21st century.

The Importance of Economic Growth

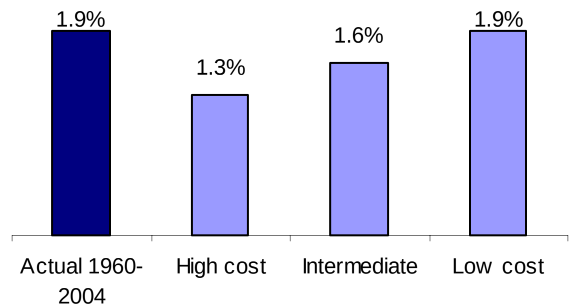
> ***Strong economic growth leads to a strong Social Security system. If the U.S. economy continues to grow at the same rate it did during the last century, then Social Security will be able to fully fund benefits throughout the 21st century.***

For the past decade, the Trustees have used very conservative assumptions about 21st century economic growth in all three of their annual projections. For their 2005 intermediate forecast, the Trustees assumed that the U.S. economy (gross domestic product, or GDP) would grow at an average annual rate of 1.8% or 1.9% for most of the 21st century. For their most optimistic low-cost forecast, the Trustees assumed an annual growth rate of 2.5% for the economy. That compares with an actual average growth rate during the 20th century of 3.4%.

Actual Average Annual Growth in U.S. Economy and Social Security Trustee Projections



Actual Average Annual Growth in Productivity and Social Security Trustee Projections



Productivity growth is one of the key variables used by the Trustees to project overall economic growth. Because of new technology and other innovations, over time each worker is able to produce more with the same amount of work. Huge increases in agricultural productivity over the 19th and 20th centuries allowed most Americans to move off the farm. Productivity increases allow us to enjoy higher standards of living than earlier generations.

Small changes in average annual productivity growth result in big differences over 75 years. The Trustees assumed lower rates than the historical average for their intermediate and high-cost estimates. For the low-cost estimate they used the annual average from 1960 to the present, 1.9%. That long term average includes a particularly low period of productivity growth between 1975 and 1995. Since 1996, average annual productivity growth has averaged 2.5%.

Productivity growth pushes wages up faster than inflation over time. Even with their pessimistic outlook on the long-term growth of the American economy, the Trustees still project that the typical American worker will be earning 48% more in 2041 after adjusting for inflation than the average worker makes today.[3] Since Social Security benefits are adjusted to keep pace with average wages and current standards of living, promised benefits in the 2040s will also be substantially higher, about $17,000 annually for the average single retiree compared with $11,500 today.

The expected increase in both wages and promised benefits over the course of the 21st century is rarely mentioned in debates about Social Security's future. In fact, even if the intermediate projections turn out to be accurate and Congress makes no changes to the program, in 2042 Social Security will have the resources to provide the average retiree with benefits worth $1,100 more annually in real buying power than today's seniors receive. The proposal President Bush has floated to link benefits to inflation rather than wages would result in no real increase in benefits over time, even as wages and standards of living for the working population rise substantially.

As our population ages, Social Security will grow from 4.3% of GDP to 6.4% in 2079, assuming full promised benefits are paid. A 2% increase in Social Security is easily affordable. To put it in context, the federal government pays about 2% of GDP annually in interest on the national debt. The federal budget fell by more than 2% of GDP under the Clinton administration and has risen by nearly 2% under the Bush administration.[4] The tax cuts adopted in 2001 and 2003, if made permanent, represent 2% of GDP, and the federal deficit in 2005 is projected to be 3.5%.[5]

The Social Security Trustees' Annual Report of 2005, like previous reports, confirms that the Social Security system is financially secure, has the resources to finance the retirement of the baby boom generation, and can remain the foundation of economic security for American seniors and working families for generations to come.

Social Security is Better than a Privatized System

Social Security is organized as a social insurance program. It provides economic security to everyone who works, whether as a physician or nursing home attendant, CEO or janitor, college professor or day care teacher.

Social Security protects the unlucky as well as the fortunate, but it never makes anyone rich. Benefits are progressive, providing higher incomes to those who need it the most. Those who make less while working get less in monthly benefits, but the lowest earning workers receive a benefit equal to about 50% of their average pay, while the highest earners receive about 25%. Recipients with dependent children or spouses receive additional benefits. Benefits are adjusted annually for inflation regardless of the ups and downs of the economy and are guaranteed for life for retirees and their surviving spouses no matter how long they live. While most often thought of as a retirement program, one-third of Social Security recipients are disabled workers and their family members or survivors of deceased workers.

Private accounts would result in the loss or reduction of Social Security's social insurance protections. In a privatized system, *everyone's* guaranteed benefit would be significantly reduced.[6] Whether or not an individual's private account could make up the difference would depend on lifetime earnings, family circumstances, and the economy. Anyone who took time out of the labor force for family care or other reasons, worked in lower paid jobs, had dependent family members, became disabled before retirement age, lived beyond average life expectancy, or lived during a prolonged economic downturn would likely face poverty in old age.

In addition to all these disadvantages, the transition to private accounts would cost at least $1 trillion to $3 trillion in new tax dollars, since a large portion of payroll taxes would no longer be available to pay benefits for current recipients. President Bush also has not stated how survivors and disability benefits would be financed in a new system.

Investing in Education to Secure Social Security's Long-Term Future

Social Security faces no immediate financial problems. The system will never be "broke." Possible future shortfalls have been vastly overstated. Even with very conservative assumptions about future economic growth, the Trustees' projections show that Social Security will have the resources to pay every generation of Americans higher benefits than their parents received.

A number of commentators have declared that because the Social Security Trustees' intermediate projection forecasts a long-term shortfall, we have no choice but to cut benefits, raise taxes, or raise the retirement age. Many warn that we must act now with some combination of these changes in order to avoid more drastic actions later. However, focusing on current real problems rather than possible future problems would be a better approach for our economy, Social Security, and the American people.

The strength of the U.S. economy and the productivity of the workforce will largely determine the amount of the Social Security benefits that today's young workers will receive when they reach retirement age. If our economy grows over the next several decades at the tepid pace of the intermediate scenario, retirees in the 2040s could receive benefits about 10% higher after inflation than today's beneficiaries receive without a payroll tax increase or any other changes to Social Security. If our economy grows at the somewhat stronger pace of the low-cost forecast, benefits in the 2040s could be 50% higher than today.

There are several ways the federal government can strengthen the economy. The healthcare crisis and the burgeoning budget deficit are draining much needed resources. They involve complex issues and will take some time to resolve.[7] In the short-term, the best action federal and state governments can take now to strengthen the economy and raise the productivity of future workers is to invest in education.

- ***We should begin by providing high quality preschool to every 3 and 4-year old in the country.*** Far too many children start kindergarten without the grounding they need to succeed in school. Every dollar we spend on high quality preschool will pay off in higher levels of learning and higher lifetime earnings for those children.[8]

- ***We also need to invest more in K-12 education.*** American school children are lagging behind their peers in other developed and developing countries, particularly in math and science. We need to provide our children with the education they must have to compete in the 21st century economy.

- ***Finally, we should expand access to higher education.*** State governments are raising tuitions at community colleges and public universities and limiting access because of tight state budgets.[9] We need to train the next generation of innovators, researchers, and leaders, rather than turning our young people away.

It turns out that what's best for America's children right now is best for Social Security in the long run.

Notes

[1] *The 2005 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds,* Social Security Administration, www.ssa.gov.

[2] Catherine Hill and Virginia Reno, "Children's Stake in Social Security," National Academy of Social Insurance, February 2003.

[3] Dean Baker, "Weak Economy Moves Social Security Depletion Date Closer," Center for Economic and Policy Research, March 23, 2005, www.cepr.net

[4] Congressional Budget Office, "CBO's Estimate of the President's Budget for Fiscal Year 2005," p. 3; "A 125-Year Picture of the Federal Government's Share of the Economy," July 2002, www.cbo.gov.

[5] Richard Kogan and Robert Greenstein, "President Portrays Social Security Shortfall As Enormous, But His Tax Cuts And Drug Benefit Will Cost At Least Five Times As Much," Center on Budget and Policy Priorities, February 11, 2005, www.cbpp.org.

[6] Stephen C. Goss, Social Security Administration, January 31, 2002, "Estimate of Financial Effects for Three Models Developed by the President's Commission to Strengthen Social Security;" Peter Diamond and Peter Orszag, "Reducing Benefits and Subsidizing Individual Accounts: An Analysis of the Plans of the President's Commission to Strengthen Social Security," June 2002, Center on Budget and Policy Priorities and the Century Foundation, http://www.cbpp.org/6-18-02socsec.pdf.

[7] For more detail on rising healthcare costs, see Marilyn P. Watkins, "Social Security for the 21st Century," May 2004, Economic Opportunity Institute, http://www.eoionline.org/SocialSecurity/SS-Brief2004.pdf; on the federal deficit, see Max B. Sawicky, "Collision Course: The Bush Budget and Social Security," Economic Policy Institute, 2005, www.epinet.org.

[8] Robert G. Lynch, "Preschool Pays: High-Quality Early Education Would Save Billions," *American Educator*, Winter 2004-05; Lawrence J. Schweinhart, *The High/Scope Perry Preschool Study Through Age 40: Summary, Conclusions, and Frequently Asked Questions*, High/Scope Press, www.highscope.org.

[9] American Association of State Colleges and Universities, *State Fiscal Conditions*, October 2003, http://www.aascu.org/pdf/03_fiscalcond.pdf.