

**NCLR**  
NATIONAL COUNCIL OF LA RAZA

**The Social Security**

**Program and Reform:**

**A Latino Perspective**



The National Council of La Raza (NCLR) is a private, nonprofit, nonpartisan, tax-exempt organization established in 1968 to reduce poverty and discrimination and improve life opportunities for Hispanic Americans. NCLR has chosen to work toward this goal through two primary, complementary approaches: (1) capacity-building assistance to support and strengthen Hispanic community-based organizations, and (2) applied research, policy analysis, and advocacy. NCLR strengthens these efforts with public information and media activities and special and international projects. NCLR is the largest constituency-based national Hispanic organization, serving all Hispanic nationality groups in all regions of the country, with more than 300 formal affiliates who together serve 41 states, Puerto Rico, and the District of Columbia – and a broader network of more than 35,000 groups and individuals nationwide – reaching more than four million Hispanics annually.

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# **The Social Security Program and Reform:**

**A Latino Perspective**

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## Executive Summary

Changes to the Social Security system are being proposed now by lawmakers because experts predict that a funding gap will emerge within several decades, which could have serious implications for American taxpayers and retirees. The aging of the American population has put more pressure on the nation's federal retirement and social insurance systems; the longer it takes to close the gap the more it will cost workers and/or beneficiaries.

As a growing number and share of future American taxpayers and elderly residents, Latinos\* are major stakeholders in the debate over Social Security reform. Yet, the Social Security program is complex and mysterious for most workers and retirees. The program is the culmination of decades of refinements and modifications designed to respond to the social insurance needs of the American public. Today, the system is a complicated maze of programs, formulas, rules, and policies that are as difficult to understand as they are important to the people they serve. With the potential for reform looming, efforts to demystify the system and bring to light the key substantive policy concerns for selected communities such as Latinos are more critical than ever. To that end, this report and analysis reveal the following:

- **The vast majority of Latino workers are paying into the Social Security system.** A rough analysis of overall numbers shows that about 19.4 million Hispanic workers are likely contributors to the system. These include the 8.6 million who are native-born (the bulk of those workers are in Social Security-covered jobs), 5.9 million who are lawfully-present foreign-born workers, and an estimated 4.9 million who are undocumented.\*\* Social Security Administration (SSA) officials assume that about three out of four undocumented immigrants pay payroll taxes.\*\*\* Thus, about 93% of Latino workers are paying into the Social Security system.
- **Compared to their White and Black peers, in many categories Latinos are the least likely to receive Social Security benefits at all.** Of all elderly Hispanic couples, 16% do not receive benefits, compared to 8% of White couples and 11% of Black couples.

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\* The terms "Latino" and "Hispanic" are used interchangeably by the U.S. Census Bureau and throughout this document to identify persons of Mexican, Puerto Rican, Cuban, Central and South American, Dominican, and Spanish descent; they may be of any race.

\*\* Estimates by Jeff Passel of the Pew Hispanic Center, based on March 2003 Current Population Survey with legal status assignments based on Urban Institute methodology.

\*\*\* *Illegal Immigrants Are Bolstering Social Security With Billions*, *New York Times*, April 5, 2005.

- **About one in four Latino workers is ineligible to receive Social Security benefits.** The most recent reliable data suggest that 4.9 million Latino immigrants are undocumented and working in the U.S. even though 75% pay into the system. If this number is reasonably accurate, that would mean that at least 25% of Latino workers in the U.S. are categorically ineligible to receive Social Security benefits based on immigration status.
- **Many Latino workers who may be native-born or lawfully present are also outside of the system.** Because many Hispanic workers, especially women, are in informal sectors of the labor market or in occupations as domestics and childcare workers, Social Security rules may prevent them from earning quarterly credits that help them qualify for retirement benefits. Moreover, enforcement of earnings reporting is lax in certain sectors, particularly for domestics and farmworkers, which may hamper a worker's effort to reach the 40-quarter minimum and qualify for Social Security retirement benefits.
- **For those Latinos who receive Social Security benefits, the poverty-reducing impact is significant.** In the absence of Social Security benefits, the poverty rate of elderly Hispanics who are eligible for Social Security would more than triple, from 16% to 55%.
- **Despite the positive impact of Social Security benefits on Latino beneficiaries, Latinos tend to have shorter covered-earnings histories, lower average monthly earnings on record, and consequently lower Social Security benefits than others with similar lifetime earnings.** The median benefit for elderly Latino couples in 2002 was only 79% of White couples' benefit.
- **Because adequacy of benefits is a challenge for Latino beneficiaries, a disproportionate share of Hispanics receiving benefits requires some degree of income supplementation.**

The manner in which Latinos currently interact with the Social Security system provides guidance for policy-makers deliberating over reform options. Solvency of the system is a major goal for Latino workers and families and should be acted on by policy-makers whether or not they agree that the system should include private accounts. On the question of how best to make the system solvent, some leading findings in the report encourage policy-makers to:

- Include measures and provisions that shield from or mitigate the impact of solvency solutions on low-income workers.
- Oppose the following measures: 1) across-the-board cost-of-living adjustment (COLA) reductions; 2) changes to the benefit formula which increase the number of years factored into it; and 3) measures that would further reduce the benefit replacement rates for low-income workers.
- Support the following provisions: 1) lifting the cap on wages subject to Social Security taxation from \$90,000 and 2) the inclusion of state and local workers who are currently out of the Social Security system.

- Consider the following: 1) an expansion of the base of revenues subject to payroll taxes outside of wages by looking at capital gains and an estate tax surcharge; 2) modest benefit cuts by slowing the growth in benefits for the highest-income seniors; and 3) modest changes to the normal retirement age if improvements to the disability insurance program can be instituted.

Social insurance is important and vital to all American workers. However, the Social Security system could cover more Latino workers more effectively. As noted above, for a variety of reasons Latinos receive lower-than-average benefits and are less likely than other American workers to qualify for Social Security retirement benefits. This report finds that expanding social insurance protections must be a consideration for lawmakers and that policy-makers should:

- Expand coverage by reducing the earnings threshold required for domestic and other itinerant workers to qualify for a quarter of coverage.
- Improve enforcement of earnings reporting in selected industries where underreporting is prevalent.
- Enhance or reform the special minimum benefit (SMB) to ensure that Social Security beneficiaries have above poverty income levels.
- Support ratification of the U.S.-Mexico totalization agreement, which will also help to extend important insurance coverage to many Mexican workers employed in the U.S.
- Consider measures that would provide quarters of Social Security credit to those who stay home to care for children.
- Oppose measures that would exclude tax contributions of workers when immigrants who are lawfully present apply for retirement benefits.

On the pivotal question of private accounts and the Social Security system, there are many uncertainties and risks with this endeavor and healthy skepticism is warranted. Fundamental restructuring of a social insurance system as delicately balanced and as vital to beneficiaries as Social Security raises a number of critical issues of particular interest to Latinos which reformers will have to address. This report finds the following elements of private accounts of particular interest for Latinos:

- A progressive account structure or account design that includes some type of governmental match for workers with lower incomes.
- Full access to private accounts regardless of immigration status with all contributions that meet standard rules qualifying for quarters of credit.
- Financial counseling that would provide Latinos and other low-income workers who have limited experience in retirement savings with access to individual, one-on-one certified counselors.

- A mechanism or provision that guarantees a residual benefit in a private account (after accounting for annuity costs and offsets) to a low-income worker during the payout phase.

That said, the private accounts policy question has boiled down to whether the accounts should be carved out of, added on to, or established wholly outside of the current Social Security system. NCLR has welcomed the debate on Social Security and retirement security and wishes to consider all options. In this context, the report finds the following:

- **There are no realistic conditions under which a private account carve-out proposal would benefit Latinos, or low-income workers, to the same degree as upper-income workers.** Although it is possible to construct intellectually a private account carve-out system that is fair and beneficial for Latino workers, such a system is unlikely to be developed, enacted, or administered in a way that would maintain the integrity, equity, or social insurance character of the current system. A carve-out system would have to address substantively all of the major issues noted (progressive structure, financial counseling, guaranteed residual benefit, full access, and maintenance of a universal structure) as well as shield low-income workers from adverse impacts of solvency solutions. The plan would have to make improvements in ancillary benefits (e.g., disability and survivors), increase the minimum benefit on the defined-benefit side, and finance the transition in such a way that would not undermine the ability of Congress to make important domestic investments in the future. Such a system is politically unpalatable, would be enormously expensive to administer, and would likely be the most inefficient means of increasing overall retirement savings. Accordingly, carve-out plans should be opposed on the merits.
- **An add-on private account could be beneficial to Latinos.** Such accounts could more easily address many of the policy concerns noted above. For example, accounts for low-income workers could be matched, risk is minimized because the defined-benefit remains intact with no needed offsets, and accounts could produce meaningful ownership of assets for low-income workers. Of course, financing would have to be addressed, and it is uncertain how this could be accomplished given the outlook of the federal budget.
- **Changes and modifications to existing 401(k) or similar retirement savings vehicles and enhancements in the private pension marketplace could also be beneficial for Latinos.** Such changes should be undertaken whether or not a private account is added to the Social Security system. Several measures beneficial to Latinos would include: 1) expanding, making permanent, and making refundable the Saver's Tax Credit; 2) allowing for increased administration of automatic features to pension plans (e.g., automatic enrollment); and 3) creating a system and network that would provide free access for low-income workers to financial counselors for the purpose of retirement savings planning.

The Social Security program is complex and mysterious to most workers and retirees. It has been one of the most popular and effective government programs for 70 years, which is largely attributable to its social insurance character. The program is the culmination of decades of refinements, modifications, and amendments, all designed to respond to contemporary challenges and emerging public needs. The system has been quite effective as an anti-poverty strategy because of its many progressive features such as base benefit formula, disability and survivor benefits, and cost-of-living adjustments that keep benefits at pace with inflation. Also, the program has maintained broad popular support because even the highest income workers receive a guaranteed benefit.

NCLR seeks to maximize policy outcomes for the growing Hispanic community. This involves maximizing benefits and minimizing costs from any reform proposal within the framework of maintaining the social insurance and universal character of the system. Undermining the central tenets of the system would threaten the survival of the Social Security program and should be resisted by policy-makers. Policy-makers should also be mindful of the increasing demographics of the Latino community and be wary of financing measures that would endanger investments in key Latino priorities such as education and health care.

Given the importance of social insurance, retirement savings, and wealth-building to Latinos, NCLR is committed to reviewing the policy arguments, weighing the options, and making an honest assessment of reform plans on the merits in light of the impact on the growing Latino population. This report lays the substantive groundwork for efforts in this area that seek to produce policy outcomes that are beneficial for Latinos.



## Introduction

**T**he 70-year-old Social Security program is one of the most successful government achievements in the nation's history. The program enjoys widespread popular support and touches tens of millions of American workers and retirees. Overall, more than two out of five elderly Americans would have income below the poverty line without the receipt of Social Security,<sup>1</sup> not to mention the critical income support it provides for the disabled and survivors and dependents of workers who have paid into the system.

According to policy experts, if major U.S. demographic and economic trends remain relatively constant and predictable, the system should continue to meet its obligations to retirees for another 35 to 45 years. Beyond that point, however, the Social Security system will come up short and will require changes in order to continue to effectively serve American retirees as well as it does today.

In view of this shortfall, President George W. Bush has placed Social Security reform at the forefront of his second-term agenda. Though much of the recent work and debate on how to preserve, possibly restructure, and reform the system has been relegated to the academic world, few options have actually come to fruition as a bill; however, Congress and the President are closer than ever to developing and debating an actual reform plan. Moreover, lawmakers are taking the issues directly to the American public, demonstrating that few policy debates are more politically and ideologically polarizing than Social Security reform.

Hispanic Americans numbered nearly 40 million in 2004; more than 19 million are in the U.S. workforce and another two million are over 65 years of age.<sup>2</sup> More than 7.5 million are active voters – a number likely to increase substantially before the 2006 elections – and projections reveal that Latinos by 2050 will constitute nearly one in four (24%) U.S. residents.<sup>3</sup> Clearly, Latinos are major stakeholders in the debate over Social Security reform.

Nevertheless, much of the existing information about Social Security reform, which could have generated greater involvement and attention by Latino stakeholders, has been tainted by partisan or ideological motivations. The need for balanced analysis that informs Latinos about the Social Security system and reform options has become more critical than ever.

Accordingly, this report seeks to paint a picture of the Latino community and ask and answer, as best we can, several basic questions about the Social Security system. For instance: What does the Social Security system do? How well does the system work for Latinos? What are the challenges to the system? How should policy-makers proceed on Social Security reform? The Social Security program is complex and the issues can be arcane and difficult to comprehend fully. This report seeks to identify and demystify those aspects of the system that are most critical for Latinos. Our understanding of the role of Social Security in the lives of Latinos will guide our analysis of reform options and help to recognize the decisive questions that Latinos should ask of policy-makers as they move forward with their deliberations.

## What Does the Social Security System Do?

**T**he Social Security system, or Old-Age, Survivors, and Disability Insurance (OASDI) program, insures workers and their families against the potential loss of earnings due to old age, disability, or death. Because it is a mandatory social insurance program and almost all U.S. workers must participate, Social Security can spread the risk of lost earnings among many workers, allowing healthy and able workers to care for those who are not. It is a "pay as you go" system, wherein current workers pay for the benefits received by current retirees, survivors, and disabled workers via a tax on wages of 6.2% for both employer and employee.\* With this structure each generation of workers supports the retired, and eventually those workers are, in turn, supported during their retirement by younger workers.

### Dependent and Survivor Benefits

An important feature of Social Security is the family income insurance it provides in the event of a worker's retirement, disability, or death. A retired worker's spouse receives a benefit equal to half of the worker's benefit, if that is larger than the spouse's own retirement benefit. This provides extra income in old age for spouses who did not work outside the home. The spouse benefit is somewhat controversial, because it redistributes income from low-wage workers to spouses of high-wage workers, who could afford not to work, and means that some spouses who do work get little extra Social Security benefit in return for their FICA taxes.

A widow(er) receives the full amount of the deceased worker's benefit, or his or her own benefit, whichever is larger. The amount by which the widow(er)'s benefits decline upon the retired worker's death depends upon the amount of his or her own Social Security benefit.\*

Dependent children (and parents) of deceased and disabled workers also receive benefits. These dependent and survivor benefits are important in reducing child poverty.

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\* If the widow(er)'s own benefit is smaller than the deceased spouse's benefit, a 33% drop in benefits occurs. If the widow(er)'s own benefit is equal to that of the spouse, there is a 50% drop in benefits. (Christina Smith FitzPatrick and Joan Entmacher, *Increasing Economic Security for Elderly Women by Improving Social Security Survivor Benefits*, January 2000.) As the surviving spouse's estimated expenditure needs drop by only 21% upon the retired worker's death, the drop in benefits will exceed the drop in expenditure needs, regardless of the amount of his or her own benefit.

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\* For 2005, the maximum amount of earnings subject to the payroll tax is \$90,000. This amount increases each year, usually by legislation. In the absence of legislation, it is automatically increased in multiples of \$300, provided that there is a cost-of-living increase in Social Security benefits. (See the *Social Security Handbook* at [http://www.ssa.gov/OP\\_Home/handbook/handbook.13/handbook-1301.html](http://www.ssa.gov/OP_Home/handbook/handbook.13/handbook-1301.html))



Social Security benefit amounts are based on one's earnings history, with a minimum of ten years' work covered under Social Security required to qualify for retirement benefits. The highest 35 years of earnings are averaged to determine a retired worker's benefit. Disability benefits are available to those who worked in covered jobs for at least half the time in the ten years before becoming disabled (fewer for workers in their twenties). Survivor benefits are available for the widow(er), children, and dependent parents of deceased workers with even fewer years of covered earnings (see text box on page 2 for information on dependent and survivor benefits).

Social Security's progressive benefit formula gives larger benefits to higher earners, but replaces a larger fraction of earnings for low-wage workers. The benefits for workers and their spouses continue until death, with a cost-of-living adjustment (COLA) each year to index for inflation, so a person cannot outlive the income and purchasing power does not erode over time. The spouse benefit (equal to half of the retired worker's benefit) and the survivor benefit (equal to 100% of the retired worker's benefit) helps spouses and widow(er)s who mainly worked at home caring for the family. Social Security benefits for dependents of disabled workers and for surviving children of deceased workers give more income to families with children.\*

Certain characteristics of the Latino population point to important potential interactions with the Social Security system. Specifically:

- **Latinas have more children but lower labor force participation rates compared to their peers.** The average Latina aged 40 to 44 in 2002 had 2.4 children, compared to 1.8 for the average White non-Hispanic woman.<sup>4</sup> However, only 58% of Latinas, but 61% of non-Hispanic women, were in the labor force in March 2002.<sup>5</sup> Income insurance is important to workers with dependents.
- **Latinos have longer life expectancies than other workers.** In 2004, Hispanic men aged 65 could expect to live another 19.5 years, 3.0 years longer than White non-Hispanic men and 4.4 years longer than Black non-Hispanic men. Latinas' life expectancy at age 65 is an additional 22.8 years, 2.9 years longer than White non-Hispanic women and 4.2 years longer than Black non-Hispanic women (see Table 1 on page 4).<sup>\*\*</sup> A retirement benefit that maintains its value for as long as a person lives is financially advantageous for workers with long life expectancies.

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\* Generally children's benefits end at age 18; however, benefits might not end if child is disabled or is in secondary school full-time until age 19.

\*\* The accuracy of these estimates is somewhat questionable as 1) death registration data were not available for years after 1996, 2) the populations used as denominators for all of the death rates underlying the calculated life expectancies predated the results of the 2000 Census, and 3) Hispanics' assumed mortality advantage has been a subject of some controversy. Some claim that immigrants may have lifestyle habits – imported from their countries of origin – that may favor longer life, while others suggest that Hispanic origin is more likely to be missed on death certificates (in which a medical examiner is responsible for filing the report) than on census reports, where the form would be filed by a head of household; this would cause a downward bias in Hispanic mortality rates, resulting in an upward bias in life expectancy.

**TABLE 1**

**Life Expectancy by Race/Ethnicity, Sex and Age, 2004 in Additional Years**

<b>Race/Ethnicity, Sex</b>	<b>22</b>	<b>Age 34</b>	<b>65</b>
Hispanic			
Both sexes	60.1	48.76	21.35
Male	56.99	45.97	19.48
Female	63.02	51.31	22.85
White, non-Hispanic			
Both sexes	56.95	45.45	18.29
Male	54.32	42.98	16.43
Female	59.5	48.78	19.9
Black, non-Hispanic			
Both sexes	52.66	41.63	17.07
Male	49.36	38.66	15.12
Female	55.61	44.23	18.61

Source: U.S. Census Bureau, 2004 Life Tables, from *Projections of the United States by Age, Sex, Race, Hispanic Origin, and Nativity: 1999-2100*.  
[http://www.census.gov/population/projections/nation/detail/tt99\\_10.a](http://www.census.gov/population/projections/nation/detail/tt99_10.a)

- **Latinos have high rates of employment disability.** Of Hispanics aged 16 to 64, 16.7% have an employment disability compared to 16.9% of non-Hispanic Blacks and 10.1% of non-Hispanic Whites.<sup>6</sup> Insurance against the risk of disability before reaching retirement age is important for all workers, but especially for those who are at high risk.
- **Latinos have lower average earnings than their counterparts.** In 2001, 53% of all Hispanic workers earned less than \$25,000, but only 25% of White non-Hispanics earned as little.<sup>7</sup> A retirement system that accounts for income needs during retirement in addition to wage contributions during working years is important for low-wage workers.
- **Latinos are less likely than others to have employer-provided pension coverage and are less likely to participate in pension plans, if offered, than other workers.\*** In 2001, only 26.3% of Hispanic workers participated in an employer-provided pension plan, compared

\* There is a large participation gap for Latino workers with access to pension plans. Low levels of participation for workers in general and for Latinos are attributed to both worker and pension plan characteristics. These characteristics are workers with low income levels, who are younger, and have more financial dependents. As Latinos tend to have lower incomes, are younger, and tend to have more financial dependents, some of the pension participation gap can be attributed to these characteristics. A pension plan's structure can make it even more difficult for workers with these characteristics to fully participate in the given plan. Employer matching, salary reduction option, automatic enrollment, or loan options can affect the participation rates of Latinos.

to 43.2% of all U.S. workers.<sup>8</sup> As a result of low levels of pension plan participation, only 19% of Hispanics aged 65 or older received income from pensions in 2002, compared to 30% of Blacks and 42% of Whites.<sup>9</sup> A mandatory and universal system that provides a basic retirement benefit for all workers is essential, especially for those workers less able for whatever reasons to participate in pension savings.

Hispanics also receive much less income from assets than do non-Hispanic Whites. Assets can be liquidated during retirement years to support workers and their families. In 2002, only 26% of elderly Hispanics had income from assets, compared to 59% of Whites.<sup>10</sup> Ownership of financial assets, which are more easily accessed, is especially low for Hispanic households. In 2002 fewer than 10% of Hispanic households owned stock and mutual funds, compared to a 35% ownership rate for White households.<sup>11</sup>

Furthermore, persons who are eligible for Social Security benefits are automatically entitled to the Medicare health insurance program (see text box on Medicare and Medicaid below). Given the challenges that Latino workers have with access to health care – they are more likely than all other Americans to lack health insurance – this feature is particularly important.

#### Medicare and Medicaid

Elderly and disabled persons who are eligible for Social Security benefits are automatically entitled to the Medicare health insurance program. Medicare covers most hospital, doctor, and post-hospital skilled nursing bills. Currently, a drug discount card is available to most beneficiaries, and some low-income beneficiaries can receive a \$600 subsidy to help with the cost of prescription drugs. Beginning in January 2006, beneficiaries have the option of paying a monthly premium for drug benefits. Medicare generally does not pay for long-term care.

Low-income persons who are not eligible for Medicare may be eligible for Medicaid, a joint federal-state program whose eligibility requirements and provisions vary from state to state. The main groups covered by Medicaid are families on public assistance, other poor and near-poor children and pregnant women,<sup>\*</sup> Supplemental Security Income recipients, and other low-income elderly and disabled persons. Medicaid covers prescription drugs and, unlike Medicare, it does cover long-term nursing-home care.

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\* Except for legal immigrants who arrived in the U.S. after 1996.

**TABLE 2**

<b>Participation in Medicare and Medicaid,* 2002</b>			
	<b>Hispanics</b>	<b>White, Non-Hispanics</b>	<b>Blacks</b>
Covered by Medicare			
% of Total Persons	6.4	15.8	10.5
% of Elderly	90.2	96.4	92.3
% of Poor Elderly	90.3	94.6	93.8
Covered by Medicaid			
% of Total Persons	20.2	7.7	23.2
% of Elderly	26.9	6.7	19.3
% of Poor Persons	42.3	34.4	51.1
% of Poor Elderly	44.0	22.7	36.9
% of Poor Children	61.2	57.5	69.7

Source: U.S. Census Bureau, Current Population Survey, 2003 Annual Social and Economic Supplement (2002 Income), Tables HI01 and HI03.  
<http://ferret.bls.census.gov/macro/032003/health/toc.htm>. Numbers rounded.

\* There is a select group of individuals who qualify for both Medicare and aspects of the Medicaid program. Known as "dual eligibles," these persons may receive benefits under Medicare Part A and/or Part B as well as some form of Medicaid. Table 2 reflects the inclusion of this particular group of people.

The Social Security system forms the core of social insurance for American workers. Social insurance is especially relevant for the share of the population with more dependents, at high risk of disability or death during their working years, and with few chances to save money on their own.

## How Well Does the System Work for Latinos?

**A**s the previous section notes, the socioeconomic characteristics of the Latino community suggest a high need for social insurance as well as significant interactions with the Social Security system. But how well does the system work in practice for Latinos? An analysis of participation, benefit receipt, and adequacy of benefits for Hispanics may shed light on this.

### Participation

Available data suggest that Latinos participate in the Social Security system at high levels, although there are no precise data on the number of Latino workers actually contributing to the OASDI system. Rough estimates indicate that 19.4 million Hispanic workers contribute to the system. These include the 8.6 million who are native-born (the bulk of those workers are in Social Security-covered jobs), 5.9 million who are lawfully-present foreign-born workers, and the estimated 4.9 million who are undocumented.<sup>12</sup> Social Security Administration (SSA) officials assume that about three out of four undocumented immigrants pay payroll taxes.<sup>13</sup>

The large share of Latino workers contributing to the system is reflected in Table 3 on page 8, on page 16 which shows levels of receipt of benefits by Hispanics. For example, in 2002:

- More than three out of four (77%) Latino elderly, those 65 and older, received Social Security retirement benefits.
- More than one-quarter (26.8%) of Hispanics who are work-disabled received Social Security income, compared to 28% of Blacks and 33.8% of Whites.<sup>14</sup>

Hispanics are also more likely than other groups to receive Social Security disability benefits. In a report issued by the General Accounting Office (GAO),<sup>\*</sup> Latinos made up only 8.4% of the sample, but 10.1% of Disability Insurance (DI) beneficiaries.<sup>15</sup> These contribution estimates and participation figures notwithstanding, the evidence suggests that a substantial and disproportionate share of Latinos is not connected fully to the Social Security system. Table 3 also reveals that in 2002:

- Of all Hispanic elderly couples, 17% did not receive retirement benefits, compared to 8% of White couples and 13% of Black couples.
- More than 25% of unmarried Hispanics did not receive retirement benefits, compared to 18% of Blacks and 9% of Whites.

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\* The General Accounting Office's (GAO) name was changed to the Government Accountability Office on July 7, 2004 as part of the GAO Human Capital Reform Act of 2004, Pub. L. 108-271, 118 Stat. 811 (2004).

Low-income Latino families with children are also less likely than Blacks or Whites to receive Social Security survivor or dependent benefits. In 1998, only 6% of Hispanic families with children in the lowest quintile (the poorest 20% of families) received benefits, compared to 8% of Black families and 8% of White families in this income bracket.\*

**TABLE 3**

<b>Receipt of Social Security, 2002</b>			
	<b>Hispanics</b>	<b>Blacks</b>	<b>Whites</b>
<b>Receiving Social Security benefits</b>			
% of couples aged 65+	83	87	92
Median amount of SS received	\$13,716	\$14,496	\$17,296
% of unmarried men aged 65+	75	82	89
Median amount of SS received	\$8,400	\$9,288	\$11,448
% of unmarried women aged 65+	72	81	91
Median amount of SS received	\$7,596	\$7,848	\$10,248

Source: Social Security Administration (2005), *Income of the Population 55 or Older, 2002*, Tables 1.3, 5.A3.

Undoubtedly, lower relative levels of benefit receipt for Hispanics can be attributed to the dynamic relationship between the makeup of Latino workers, their status in the labor market, and Social Security rules and policies.

As noted earlier, workers need to be employed in a Social Security- "covered" job for a minimum of ten years (not necessarily consecutive), or 40 quarters, in order to qualify for Social Security retirement benefits. Several factors particular to Latinos and inherent in the nature of low-wage work may hinder efforts of Hispanic workers to meet this threshold. These factors are often augmented by the fact that 45% of Latino workers are foreign-born, and immigrant workers face other challenges with Social Security rules that hinder full access to the system. For example:

- **Low Labor Force Participation for Hispanic Women.** Nearly half of all Latinos in the U.S. are women, and more than two in five Hispanic women in the U.S. are not in the

\* According to a study by the National Urban League in 2000, which utilized data from 1998, this quintile is composed of families with incomes of \$21,188 or less who live in poverty: 74% of Latino families with children, 69% of Black families, and 60% of White families. Although more Latino families were at this lower-income quintile level, compared to Blacks and Whites, fewer received benefits from the Social Security system. For further discussion, see Rawlston, Valerie A., *The Impact of Social Security on Child Poverty*. Washington, DC: National Urban League, 2000.

labor force. In 2004, Latinas over 16 years of age made up almost 1.7 million of the more than 16.5 million part-time women workers over age 16.<sup>16</sup> Moreover, 1.2 million of these Latina part-time workers were engaged in part-time employment for noneconomic reasons. Women are more likely to take time out of the workforce or to work part-time in order to provide care for children or parents. This can affect not only receipt of benefits, but also the ability to access pension coverage and contribute to other types of private retirement savings.

- **Underreporting of Earnings.** In 2000, 7.4% of Hispanic workers were in farming, forestry, fishing, or private household service occupations, compared to only 2.7% of non-Hispanics.<sup>17</sup> In 2004, Latino workers heavily dominated particular industries;<sup>\*</sup> Latinos made up 12% of all workers in retail trade, 31.4% of all private household workers, and 35.5% of all workers in support activities for agriculture and forestry.<sup>18</sup> Because enforcement of earnings reporting is lax, particularly for domestics and farmworkers, earnings are seriously underreported for these workers, which may hamper a worker's effort to reach the 40-quarter minimum.
- **High Earnings Thresholds.** To receive credit for a quarter of covered employment, a worker's earnings must meet a minimum threshold. In 2005, the threshold is \$920 for most workers and occupations for each quarter of credit of coverage up to four credits a year.<sup>19</sup> However, for domestic workers in particular, the minimum amount of cash paid to an employee to be eligible for Social Security benefits for 2005 is \$1,400 to receive one quarter of coverage.<sup>20</sup> This earnings threshold, which has risen steadily since 1998, will continue to rise as it is adjusted in future calendar years in multiples of \$100 based on changes in average wages. Furthermore, the threshold applies to a single employer only; workers cannot combine payments from multiple employers in order to qualify for benefits. Therefore, domestic workers who work for several employers may not earn enough from a single employer to meet the earnings threshold. The higher threshold for domestic workers was a policy change established by Congress which was designed to minimize the burden on employers and respond to the political fallout from the "nanny-gate" scandals of the early 1990s. In practice, however, this makes it difficult for domestics, farmworkers, and other workers to qualify for benefits.<sup>21</sup> The rules for reporting domestics' and farmworkers' wages are already complex; employers may not fully understand and comply with them, increasing the likelihood that workers will not qualify for benefits.

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\* In 2002, the last year that the Bureau of Labor Statistics (BLS) had a category called "farmworkers," 45% of all farmworkers and 34% of private household workers were Hispanic.

There are also certain categories of workers who are exempt from paying into the Social Security system. These workers are foreign agricultural workers who are lawfully present in the U.S. on a temporary basis, and work performed by noncitizens or nonresidents for American employers abroad is not considered covered employment. The number of exempt workers is difficult to calculate. However, estimates reveal a temporary workforce of about 1.5 million, which includes people in the United States temporarily on student visas and dependents of workers who are present with temporary worker visas. Workers from Latin America make up approximately 6.6% of this share of temporary workers.<sup>22</sup>

The aforementioned challenges affect almost half of Latino workers regardless of their origin of birth. But another challenge is the substantial number of Latinos in the workforce who are undocumented or may have begun working in the U.S. unlawfully and have limited quarters to count toward retirement benefit eligibility. The most recent reliable data suggest that 4.9 million Latino immigrants are undocumented and working in the U.S. If this number is reasonably accurate, this would mean that about one in four (25%) Latino workers in the U.S. is categorically ineligible for Social Security benefits.

A worker's citizenship status is generally not taken into account when determining quarters of coverage. In general, as long as a worker can prove that the earnings in covered employment were his or hers, SSA will grant the worker credit. SSA creates work histories for all individuals paying into the system, even when some of the earnings occur under non-work Social Security numbers or belong to noncitizens unlawfully present in the U.S. at the time of the earnings and who later obtain a valid Social Security number. Because the Latino foreign-born population has grown over the previous decade, if all things remain the same, a growing share of Latinos is likely to experience challenges accessing OASDI benefits in the future.

Notwithstanding this, many Latino immigrants currently ineligible for retirement benefits are paying into the Social Security system (see Earnings Suspense File text box on page 11). As of October 2003, SSA posted 9.6 million wage items to its Earnings Suspense File for tax year 2001, which represented nearly \$56 billion in wages.<sup>23</sup> This amount represents about 1.5% of total wages. SSA officials acknowledge that the system's long-term funding hole for the 75 years solvency projection period would be 10% deeper without the flow of payroll taxes into the Suspense File.<sup>24</sup> Many will receive no benefits while others who later acquire a valid Social Security number may become eligible for benefits.



### Earnings Suspense File (ESF)

Employers are required by law to maintain records of wages paid to employees and to report those wages to the Social Security Administration (SSA) at the end of each tax year.<sup>\*</sup> If an employee's wages are reported with an invalid name and/or Social Security number, the earnings cannot be posted to the worker's earnings record in the Master Earnings File (MEF).<sup>\*\*</sup> Instead, these earnings go into the Earnings Suspense File (ESF), a repository for unmatched wages, until they can be posted to the correct individual's earnings record. Earnings that cannot be matched to an individual's earnings record can result in either 1) a worker being unable to qualify for benefits or 2) a lower level of benefit for that worker. Although SSA can usually match about 96.4 % of reported earnings, the amount of earnings that cannot be posted continues to grow. As of 2003, approximately 244 million wage items could not be matched to the appropriate earnings record, resulting in the accumulation of about \$421 billion in wages in the ESF.<sup>\*\*\*</sup> According to a 2001 SSA report, nine states accounted for more than 70% of the wage items in the ESF; California alone accounted for 35% of these wage items.<sup>\*\*\*\*</sup> Furthermore, three industries – agriculture, bars and restaurants, and services – account for almost one-half of suspended wage items.<sup>\*\*\*\*\*</sup> Agriculture alone accounts for 17% of suspended wage items.<sup>\*\*\*\*\*</sup> Administrators report that accumulations within the ESF are included in long-term actuarial calculations, meaning that immigrants who may never receive any benefit for their contributions are helping to sustain current benefits to retirees and preserve the Social Security system.

\* Social Security Administration, *Program Operations Manual System*, RM 01101.003 explaining Pub. L 94-202. Available at <http://policy.ssa.gov/poms.nsf/lnx/01011010031opendocument>

\*\* The MEF contains all data on earnings reported by employers and self-employed persons. These earnings are used to calculate an individual's Social Security benefit.

\*\*\* *Testimony on The "ITIN" and Social Security Number Misuse*, presented by Patrick P. O'Carroll, Jr., Social Security Administration, before the Subcommittees on Oversight and Social Security, Committee on Ways and Means, U.S. House of Representatives, Washington, DC, March 10, 2004.

\*\*\*\* Social Security Administration, *Status of the Social Security Administration's Earnings Suspense File*, A-03-03-23038. Washington, DC: U.S. Government Printing Office, 2002. Available at <http://www.ssa.gov/oig/ADOBEPDF/A-03-03-23038.pdf>

\*\*\*\*\* Social Security Administration, *Obstacles to Reducing Social Security Number Misuse in the Agriculture Industry*, A-08-99-41004. Washington, DC: U.S. Government Printing Office, 2001. Available at <http://www.ssa.gov/oig/ADOBEPDF/A-08-99-41004.pdf>

\*\*\*\*\* *Ibid.*

Because Social Security benefit receipt is more difficult for Latinos than for other workers due to immigration histories and work in the informal sector, elderly Latinos are much more likely to receive Supplemental Security Income (SSI) than are other groups of workers. SSI is a means-tested program that provides benefits to individuals who do not have enough

reported earnings to qualify for Social Security, or who receive a low level of Social Security benefits (see Supplemental Security Income text box below). Because Latinos tend to have fewer years of covered employment, and consequently lower Social Security benefits, they are

### Supplemental Security Income

The Supplemental Security Income (SSI) program provides a basic safety net for needy elderly, disabled, and blind persons. It provides income- and asset-tested benefits for those who do not qualify for higher regular Social Security benefits because of a short "covered" work history or low earnings. As of 2004, individuals were income-eligible if their earned income was \$1,213 or less per month and the individual's unearned income was \$584 or less per month. Couples were income-eligible if their earned income was \$1,777 or less per month and their unearned income was less than \$866 per month.\* Some forms of earned income and asset income are exempt. Unearned income includes payments from Social Security benefits, workers' compensation, pensions, annuities, rent, and interest income.

Thus, as shown in Table 4 on page 13, SSI is particularly important as a safety net for Latinos who worked intermittently for very low wages, who didn't always work in Social Security-covered jobs, or who immigrated to the U.S. late in life. Almost 10% of all Latino workers came to the U.S. after they were 30 years old.\*\*

The maximum federal SSI benefit is adjusted for inflation each year. For 2005 it is \$579 per month for an individual or \$869 per month for a couple who are both eligible, which is below the poverty line. It is reduced by one-third for persons who live in someone else's household and receive food and shelter. SSI benefits are reduced dollar for dollar by income from other sources, including Social Security, above a low threshold dollar amount. They are also subject to an asset test. Medicaid coverage may go along with SSI receipt. Therefore, losing SSI benefits due to increased income or assets often entails loss of health insurance as well.

Depending on one's status, immigration can be another barrier to qualifying for SSI benefits. As a noncitizen, eligibility depends on whether one was lawfully living in the U.S. on or before August 22, 1996 and blind or disabled at that time or whether one was receiving SSI at that time. A noncitizen also is eligible for SSI benefits if lawfully admitted for permanent residence and has 40 credits of work in the U.S. A person may use the work history of a spouse or parent to qualify. Other noncitizens who might be eligible are active-duty members of the U.S. armed forces, American Indians born outside the U.S., certain noncitizens admitted as Amerasian immigrants, and Cuban or Haitian entrants. Some noncitizens do have a seven-year limit on the receipt of SSI.\*\*\*

\* Social Security Administration, *A Guide to Supplemental Security Income (SSI) for Groups and Organizations*, April 2004.

\*\* NCLR's tabulations of March 1997-2001 CPS microdata.

\*\*\* Social Security Administration, *Supplemental Security Income (SSI) for Noncitizens*, January 2004.

four to five times more likely than Whites to receive SSI, which generally pays lower benefits than Social Security. Also, elderly Hispanic couples are two times more likely than Black couples to receive SSI (see Table 4 below).

**TABLE 4**

<b>Receipt of Supplemental Security Income (SSI), 2002</b>			
	<b>Hispanics</b>	<b>Blacks</b>	<b>Whites</b>
<b>Receiving SSI benefits</b>			
% of couples aged 65+	9	3	2
% of unmarried men aged 65+	10	9	4
% of unmarried women aged 65+	18	14	5

Source: Social Security Administration (2005), *Income of the Population 55 or Older, 2002*, Table 1.3.

Altogether, the evidence shows that the vast majority of Latino workers are paying into the Social Security system and the majority of current Latino elderly are receiving benefits. Nevertheless, for a variety of reasons, Latinos are more likely to face challenges accessing retirement benefits than other American workers and about one-fifth of current Latino workers are categorically ineligible for Social Security benefits. Fortunately, many lawfully-present and native-born Latino workers who have trouble meeting the 40-quarters rule may still be eligible for disability, survivor, and other social insurance programs, but lawful permanent residents arriving after 1996 remain ineligible for SSI. For example, in 2002, Latinos made up 11.9% of Social Security beneficiaries from ages 15 to 34, 8.9% of Social Security beneficiaries from ages 35 to 44, and 9.2% of Social Security beneficiaries from ages 45 to 54.<sup>25</sup> Yet undeniably a substantially higher share of U.S. Latinos relative to their peers is paying into the retirement portion of the system than will be eligible for retirement benefits. The inability to access the retirement portion of Social Security benefits leaves many Latino seniors with SSI as a primary source of support during retirement.

### Income Support

A secondary question relates to the impact of Social Security retirement benefits on those workers who do qualify and receive them. Social Security is by far the most important source of income for elderly Latinos who receive benefits. Specifically:

- In 2002, Latinos received roughly \$13 billion in total Social Security benefits. The amount paid in benefits to elderly Hispanic couples was approximately \$7.3 billion, for elderly unmarried Latino men it was more than \$1.67 billion, and for elderly unmarried Latinas it was approximately \$4 billion.<sup>26</sup>

- Among Latinos who receive Social Security benefits, 75% of their income comes from Social Security.<sup>27</sup>
- In 2002 the median annual benefit was \$13,716 for Latino married couples 65 or older.
- In the aggregate, 40% of income for Hispanic married couples over age 65, 42% of the income for older Hispanic unmarried men, and 56% of the income for older Hispanic unmarried women comes from Social Security (see Table 5 on page 15).

### Disability Insurance

Another important feature of the family income insurance that the Social Security system provides is disability insurance. The disability component of the Social Security program pays benefits to people unable to work due to a medical condition that is expected to last at least one year or result in death.<sup>\*</sup> Certain family members may also receive money from Social Security. To receive disability benefits a person must meet a "recent work" test and a "duration of work" test, which are based upon the age of the person at the time of disability and the length of time worked. The rules for eligibility under the "recent work test" are based on the calendar quarter of one's birthday and on how many years were worked during a given period before becoming disabled. For example, for a 24-year-old, one and a half years of work during the three-year period prior to becoming disabled are needed. For someone who is at least 31 years old, the individual must have worked five years in the last ten-year work period. The "duration of work" test differs in that it looks at total work time, but the work does not have to fall within a certain amount of time.<sup>\*\*</sup>

As of December 2001, Hispanics made up 9.5% of all noninstitutionalized disabled beneficiaries and 9.3% of disabled workers receiving Social Security disability benefits.<sup>\*\*\*</sup> Of Hispanics aged 16 to 64, 16.7% have an employment disability, compared to 16.9% of non-Hispanic Blacks and 10.1% of non-Hispanic Whites.<sup>\*\*\*\*</sup> The difference between these numbers indicates that Latinos may have trouble qualifying for benefits. This is troubling because of the high concentration of Latinos in jobs with substantial risk for disability. Moreover, administrative processing time can present a problem. A 2004 Government Accountability Office (GAO) study noted that SSA disability decisions take a long time to process, and individuals who initially are denied disability benefits and file an appeal still end up waiting almost an additional year before a final hearing decision is made.<sup>\*\*\*\*\*</sup>

\* Social Security Administration, *Disability Benefits*, September 2004.

\*\* Ibid.

\*\*\* Social Security Administration, *Annual Statistical Report on the Social Security Disability Insurance Program, 2003*. Washington, DC: Government Printing Office, 2004.

\*\*\*\* U.S. Census Bureau, *American Fact Finder*, Census 2000 Summary File 3. Calculations by NCLR.

\*\*\*\*\* *Testimony on Social Security Disability: Commissioner Proposes Strategy to Improve the Claims Process, but Faces Implementation Challenges*, presented by Robert E. Robertson, U.S. General Accounting Office, before the Subcommittee on the Oversight of Government Management, the Federal Workforce and the District of Columbia, Committee on Governmental Affairs, U.S. Senate, Washington, DC, March 29, 2004.

- Social Security is the sole source of income for 31% of elderly Hispanic couples and 49% of unmarried elderly Latinos. This is true for only 11% of elderly White couples and 25% of elderly White singles.<sup>28</sup>
- In the absence of Social Security benefits, the poverty rate of elderly Hispanics who are eligible for Social Security would more than triple, from 16% to 55% (see Table 6 on page 16). The poverty rate of families with children in the lowest fifth of the income distribution would be 20 percentage points higher – 91% instead of 71%.

**TABLE 5**

<b>Percent of Aggregate Income from Each Source, 2002</b>			
	<b>Hispanics</b>	<b>Blacks</b>	<b>Whites</b>
<b>Married couples age 65+</b>			
Percent of income from:			
Social Security	40	37	35
Employer pensions *	15	22	20
Earnings	35	32	30
Assets	5	5	13
Public assistance	2	1	0
Other	2	4	2
<b>Unmarried men age 65+</b>			
Percent of income from:			
Social Security	42	45	37
Employer pensions	11	17	20
Earnings	37	24	24
Assets	5	4	16
Public assistance	3	2	1
Other	2	7	3
<b>Unmarried women age 65+</b>			
Percent of income from:			
Social Security	56	55	52
Employer pensions	9	21	16
Earnings	15	13	13
Assets	10	5	15
Public assistance	8	4	1
Other	3	2	3

Source: Social Security Administration, *Income of the Population 55 or Older, 2002*, Table 7.4 (2005).

\* Employer pensions include Railroad Retirement, government employee pensions, and private pensions or annuities.

\*\* Percents have been rounded up to the next whole numeral when 0.5 or higher.

**TABLE 6**

<b>Poverty Rates With and Without Social Security Benefits, 2000</b>			
	<b>Hispanics</b>	<b>Blacks</b>	<b>Whites</b>
<b>Persons age 65+</b>			
Percent below poverty line without SS	55	60	47
Percent below poverty line with SS	16	21	7
Percent kept out of poverty by SS	39	39	40

Source: Social Security Administration, *Income of the Population 55 or Older, 2000*, Table 8.3 (2002).

Furthermore, the impact of receipt of disability and survivor benefits is also significant. For example, in one study 6% of Latino families with children in the bottom fifth of the income distribution received Social Security benefits. These families derived 61% of their income from these benefits, which reduced the poverty rate for the recipients from 91% to 71%. Another 40% were lifted out of extreme poverty (defined as income less than half the poverty threshold) by their Social Security benefits.<sup>29</sup>

The evidence shows that the social insurance benefits that Latinos receive from the Social Security system are a principal reason why fewer Latinos are poor and that these benefits often have a more significant impact on Latinos than on their peers.

### Adequacy

Participation levels and benefit effects are critical indicators of the effectiveness of the Social Security system. However, there is concern about the adequacy of the protections that the system affords eligible workers. With an average monthly benefit of less than \$1,000,<sup>\*</sup> the Social Security program can hardly be characterized as a generous program. The average annual benefit for Latinos who are eligible for Social Security benefits is \$8,365.<sup>\*\*</sup> The system is not designed to make workers better off financially in retirement than during their working years but rather to ensure a basic retirement benefit. While this underlying income insurance is important, it does have limitations for elderly Latinos.

As noted earlier, there is a distinct challenge for Latinos with respect to participation in the retirement portion of the program which undoubtedly influences overall economic status for

\* Social Security Administration, "Fact Sheet Social Security" (January 11, 2005), reports that the average retiree benefit is \$955 a month, the average disability benefit is \$894 a month, and the average survivor benefit is \$920 a month.

\*\* Calculation is based on average Social Security benefit calculated as \$7,868 average annual benefit in 2001 dollars as listed in Social Security Administration, Annual Statistical Supplement, 2003, Table 3.C8, (2004). COLA percentages were then considered. COLA percent was calculated by NCLR given that in 2002 it was 1.4% making the benefit \$7,978, 2.1% in 2003 making the benefit \$8,145, and 2.7% in 2004 which gives the \$8,365 figure.

Hispanic elderly relative to other Americans. For example, more than one in five (21%) Hispanics over age 65 had family incomes below the poverty line in 2002, compared to 9.1% of their White peers.<sup>30</sup> Many of these workers can access ancillary benefits such as disability, and some may fall into the realm of the SSI system, though there are barriers and limitations to these programs as well, as noted earlier.<sup>31</sup>

Furthermore, while the impact of Social Security retirement benefits on Latinos who qualify is positive, adequacy of those benefits remains a challenge for a disproportionate share of Hispanics. Of those Latinos who do receive Social Security benefits, nearly 19% are poor even with those benefits – more than double the rate for White elderly.

Low Social Security benefit levels for Latinos can be explained by many of the aforementioned issues such as the number of years Latinos are in the workforce, their ability to claim countable quarters of work, and their concentration in low-wage occupations. For example, even when unemployment rates were at historic lows in 1999, Hispanic unemployment rates remained at one and a half times the national average (6.4% versus 4.2%).<sup>32</sup> The employment situation of Latinos is further exacerbated by the percentage of Latinos facing long-term unemployment. In 2003, Hispanics accounted for 14% of the long-term unemployment while making up 13% of the labor force.<sup>33</sup> In addition, almost 10% of all Latino workers came to the U.S. after they were 30 years old, and the median weekly earnings for Hispanics working full-time were less than 70% of Whites' earnings in 2003.<sup>34</sup> For those who qualify, Latinos tend to have shorter covered-earnings histories, lower average monthly earnings on record, and consequently, lower Social Security benefits than others with similar lifetime earnings. The median benefit for elderly Latino couples in 2002 was only 79% of White couples' benefit (see Table 3).

That said, the Social Security system does have mechanisms designed to mitigate some of these challenges. Specifically:

- **Benefit Formula: Progressivity.** As previously noted, the progressive Social Security benefit formula helps many low-wage workers to receive a higher share of their contributions to the system than higher-wage workers. The replacement rate, which is the ratio of the retired worker's Social Security benefit to his or her average indexed monthly earnings (AIME),\* increases as a worker's wages decrease. Those in the lowest AIME quintile, meaning their AIME was \$876 or less in 2002, received a benefit that was

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\* The worker's earnings are summed and divided by 12 (the number of months in a year) to get the worker's average indexed monthly earnings (AIME). The worker's AIME is then used to calculate his or her primary insurance amount (PIA), which is the benefit that the worker would receive if he or she retires at the normal retirement age (65). It is calculated by taking 90% of the first \$612 of AIME, 32% of the next \$3,689 of AIME, and 15% of AIME over \$3,689, and then summing these amounts together. Some argue that the number of years to calculate the AIME should be raised. These are the amounts for 2004.

70.1% of their preretirement income, compared to 30.2% for those in the highest AIME quintile (see Table 7).

**TABLE 7**

**Earnings Replacement Rates of Retired Workers at First Benefit Receipt, by AIME Quintile, 2002**

AIME Quintile	Replacement Rate*
Lowest (up to \$876)	70.1
Second (\$876 to \$1,692)	50.8
Third (\$1,693 to \$2,647)	40.5
Fourth (\$2,648 to \$3,810)	35.0
Fifth (\$3,811 or more)	30.2

Source: *Social Security Bulletin*, 2003/2004

\* The replacement rate is declining over time. In the 2004 OASDI report it shows that workers who retire at the normal retirement age have the following replacement rates – 57% for low earners, 42% for medium earners, 36% for high earners, and 30% for those earning the maximum taxable wage. [http://www.ssa.gov/OACT/TR/TR04/VI\\_OASDHI\\_dollars.html#wp119381](http://www.ssa.gov/OACT/TR/TR04/VI_OASDHI_dollars.html#wp119381).

Replacement rates are generally favorable to Latinos, who earn less on average than Whites.\* The GAO notes replacement rates for 2003 as being approximately 56% of earnings for workers with low lifetime covered earnings and 42% for workers with scaled medium lifetime earnings, and workers with lifetime earnings at the maximum taxable level have approximately 30% replaced through Social Security’s progressive benefit structure.<sup>35</sup> GAO further found that for the birth cohort between 1931 and 1940, 38% of Hispanics were in the lowest-earnings quintile compared to 35% of Blacks and 17% of Whites.<sup>36</sup> Nine percent of Hispanics were in the highest-earnings quintile along with 11% of Blacks and 22% of Whites.<sup>37</sup> These data show that Latinos are benefiting from the progressive benefit structure that Social Security has in place. Furthermore, when coupled with longer life expectancies during

\* It is important to note that replacement rate calculations do not factor in unreported wages. Whether this is advantageous to a beneficiary or not may depend on his or her circumstances. However, in most cases a tradeoff of a higher benefit for a lower replacement rate is more valuable to Latino retirees given their life expectancy.



retirement, the progressive benefit formula ensures that Latino elderly fare better than most other similarly situated workers.

- **Lower Eligibility Threshold for DI.** Workers are eligible for disability benefits if they worked in covered jobs for at least half the time in the ten years before becoming disabled (fewer for workers in their twenties). The lower threshold for DI over the retirement portion of the system permits greater access to these benefits for workers in labor-intensive and often lower-wage occupations.
- **Special Minimum Benefit (SMB).<sup>\*</sup>** Those who earn low wages but have a steady attachment to the workforce throughout most of their working years may be eligible for the special minimum benefit (SMB), which was designed to provide selected workers with a higher level of benefit than the normal benefit formula. Workers must have at least 11 years of service to be eligible, and benefits are payable for each year of service up to 30 years.<sup>\*\*</sup> As a result, few individuals are entitled to the SMB. As of December 2001, only about 134,430 OASDI beneficiaries were eligible (about 0.3% of OASDI beneficiaries). Of those beneficiaries, only 79,000 receive a higher total benefit due to the SMB because it is payable only if the SMB benefit formula provides a higher benefit than the regular benefit formula.<sup>38</sup> Also, the increase in benefits that results from the SMB is relatively small; as of December 2001, the average special minimum monthly benefit was only about \$39 higher than what the beneficiary would receive under the regular formula.<sup>39</sup> The average benefit for those retired workers with unreduced benefits was \$510 per month as of February 2000, which was about \$2,000 less than the average poverty threshold for an elderly person.<sup>40</sup> The majority of the special minimum benefit beneficiaries that are retired workers are women, at 77%.<sup>41</sup> Another complication is that workers who do not reach the minimum earnings threshold receive no credit for that year, even if they fall short by only a small amount.<sup>42</sup> Furthermore, few low-wage workers acquire 30 years of service, which is needed in order to qualify for the maximum benefit. Workers in the lowest earnings quintile for those born between 1926 and 1960 had, or are projected to have, about 18 years of zero earnings within their highest 35 years of earnings.<sup>43</sup>

The President's Commission to Strengthen Social Security also recognized the potential in a minimum benefit provision for low-wage workers. Of the three models the Commission put forth, the models known as "Model 2" and "Model 3" both include a minimum benefit.<sup>44</sup>

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<sup>\*</sup> The SMB will phase out over time; it is projected that retired workers who become eligible for benefits in 2013 and later will no longer receive a greater benefit amount under the special minimum than they would from the regular benefit formula. This is because the value of the regular formula, which is indexed to wages, has increased more rapidly than the value of the special minimum benefit formula, which is indexed to inflation.

<sup>\*\*</sup> In order to qualify for a year of service, their earnings must exceed the minimum earnings threshold for that particular year. In 1991, the threshold was lowered from about 45% to about 27% of the annual average wage. Still, this lower threshold was not applied to years preceding 1991; therefore, an individual earning a given amount in 1991 and later may qualify for the SMB for those years, but may not qualify for preceding years though earning the same amount.

- **Indexed Lifetime Benefits.** The current system also contributes to poverty reduction via the guaranteed lifetime annuity with cost-of-living adjustments and the disability and survivor benefits (for children, too). Social Security's cost-of-living adjustment (COLA)\* ensures that purchasing power is not eroded for those receiving benefit payments. However, based on a current-year tax-benefit calculation, Hispanics may appear to "lose" from Social Security because they are a relatively young population, with many of working age paying FICA taxes but relatively few elderly collecting retirement benefits. However, because of longer relative life expectancies than their peers, Latinos gain on a **lifetime** basis when one compares the disability, survivor, and retirement benefits received with the taxes paid by the average Latino worker. It is estimated that Hispanic women born between 1956 and 1964 will receive almost \$85,000 more in real lifetime OASDI benefits than they paid in payroll taxes, on average, and Hispanic men will receive net benefits of \$13,500. The projected real rate of return on payroll taxes for Hispanic women born between 1956 and 1964 is 3.6%, compared to 3.5% for Black women and 3.1% for White women. The rate of return for Hispanic men is 2.2%, compared to 2.3% for Black men and 1.9% for White men.\*\*

Overall, most Latinos who are eligible for Social Security benefits receive an ample amount of income support over their retirement years and benefit greatly from the system's progressivity and indexed benefits. But a disproportionate share of Hispanic beneficiaries requires some degree of income supplementation. The mechanisms within the system that attempt to balance income needs versus actual contributions to the system are important but could be enhanced to provide more complete and adequate insurance for retirees against poverty.

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\* The COLA adjusts the Social Security benefit to inflation as determined by the increase in the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W). The COLA is calculated based on the increase in the average CPI-W from the third calendar quarter from the previous year to the current year. In December 2004, this was calculated to be 2.7%, which will be reflected in a 2.7% increase in benefits in January 2005.

\*\* Cohen, Steuerle, and Carasso (2002), Tables 2 and 3. Estimated taxes and benefits are in 1998 dollars, discounted to age 62 at a 2% discount rate. Husbands' and wives' taxes and benefits are divided equally while both are alive. Projected payroll taxes total \$125,354 for Hispanic men and \$118,513 for women; benefits total \$138,891 for men and \$202,960 for women (Appendix Tables 1 and 2). The MINT model utilized in this report utilized work and earnings histories from 1951 through 1998 for all Survey of Income and Program Participation (SIPP) respondents with a valid Social Security number born 1931-1951 which were extracted from Social Security Earnings Records. If a respondent did not have a valid Social Security number, a donor respondent was located and the donor's earnings history was hot-decked to the respondent with a missing Social Security number by finding the closest match based on sex, age, race, marital status, education, monthly earnings, and class of workers as found in the SIPP. Thus, the data on Hispanics appear to be based on the work histories of Hispanic workers who would qualify for benefits.

## What Are the Challenges to the System?

In general, the main challenge to the Social Security system is its ability to maintain long-term solvency given demographic changes. Those who would prefer a federal retirement system that was more market-driven rather than government-centered have proposed to fundamentally restructure the Social Security program. The complex issues associated with ensuring long-term solvency in the Social Security system are somewhat distinct from the challenge that some have posed on adding private accounts to the system.

The experience of Latinos within the Social Security system and their labor force status is useful to understanding how solvency remedies may impact them. Likewise, the experience of Latinos in the private retirement savings market, albeit limited, is instructive for understanding the issues for Latinos in a private accounts system. The ways in which policy-makers address these challenges will shape the economic security of the broader Latino community for decades to come. In view of this, some understanding of these issues, proposed policy measures, and key questions for Latinos are worth discussion.

### Solvency

Changes to the system are being proposed now because projections of worker productivity and wages, retirement behavior, and fertility and mortality rates imply that predicted future payroll tax revenues would be sufficient to pay only 74% of promised benefits after 2041.<sup>45</sup> By 2079, it is estimated that the shortfall will reach \$4 trillion in present value. The sooner changes are made to bring the system back into balance, the smaller those changes need to be. In 2004, the Social Security Trust Fund received more than \$658 billion and paid out \$493 billion in benefits, with the residual invested in U.S. government securities that pay interest. Social Security's actuaries predict that by 2017 the Trust Fund will pay out more than it receives in revenue and will need to tap its reserves. The Trust Fund reserves are estimated to last 25 years before they are depleted and the program begins to produce a deficit. Long-term (over the next 75 years), the gap in the system between revenues and payouts is slightly less than 2% of payroll.<sup>46</sup>

Policy-makers have a menu of options they can choose from to close the funding gap. Most proposed measures generally either reduce benefits or increase revenues, usually by increasing taxes. Below are some of the more conventional proposals in each category and how Latinos might fare given their socioeconomic characteristics.

### How Could Policy-makers Reduce Benefits?

There are many ways to reduce Social Security benefits, and experts have developed and argued for a range of policy options. Some critical questions in examining these proposals include: What is the rationale for the reduction? How much of the long-term deficit can be closed with the measure? Who is affected by the reduction and how deeply?

1. **Reduce benefits across the board.** Some observers suggest that a simple and fair way to reduce benefits is with an across-the-board cut for those newly eligible. According to Social Security actuarial estimates, if benefits were cut by 3% for those newly eligible in 2004 and beyond, about 19% of the actuarial deficit would be resolved.<sup>47</sup> If there were an across-the-board benefit reduction of 5%, about 31% of the imbalance would be funded.<sup>48</sup> This measure would hit all new beneficiaries proportionally but impose a heavier economic burden on workers with at least the following characteristics: low lifetime earnings, lower average benefits, and those solely supported by Social Security. If all other things remained the same, **Latinos would be adversely affected by this measure**, hindering the system's poverty-reducing effect on Latinos and forcing many more to rely on SSI or family members for supplemental income support.
2. **Reduce the cost-of-living adjustment (COLA).** Some experts argue that the formula used to index Social Security benefits makes the COLA<sup>\*</sup> more generous than is necessary to protect benefits against inflation. One measure would reduce the COLA by one-half of a percentage point. This is expected to fund 41% of the imbalance.<sup>49</sup> Others advocate an even greater reduction of one percentage point, which would correct 79% of the fund imbalance.<sup>50</sup> As the COLA protects against the erosion of benefits over time due to inflation, any reduction to the COLA would have a greater negative impact on beneficiaries who live longer on average as well as those more dependent on Social Security. **This change alone would negatively affect many Latino seniors**, reducing their lifetime rate of return on contributions and allowing inflation to more deeply erode their benefits.
3. **Raise the age of eligibility for full benefits (the "normal" retirement age),<sup>\*\*</sup> with consequent reduction of "early" benefits received at any given age.** Some experts argue that the Social Security system was not designed to sustain the elderly for many years of retirement; as average life expectancy grows for American workers, eligibility age for Social Security benefits should rise. One suggestion has been to speed up the increase in the normal retirement age to 67, and then index it by one month every two years until it reaches age 68.<sup>51</sup> This would eliminate about 26% of the Trust Fund imbalance. If the same were done until the normal retirement age reaches 70, approximately 33% of the imbalance would be resolved.<sup>52</sup> An increase in the normal retirement age would have an

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\* The COLA is based on the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W). It is equal to the percentage increase in the CPI-W from the third quarter of one year to the third quarter of the next year. Social Security Administration, "Latest Cost-of-Living Adjustment," October 19, 2004 available at <http://www.ssa.gov/OACT/COLA/latestCOLA.html>.

\*\* Under current law, the age of eligibility for full retirement benefits will gradually increase from age 65 to age 67 (for individuals born in 1960 or later.) The age of eligibility for early retirement is 62, with benefits being reduced based on the number of months that one begins to receive benefits before reaching full retirement age.

especially significant impact on those who have onerous jobs or who are mildly disabled but not enough to qualify for disability insurance. **Many Latinos would be adversely impacted by this measure.** For instance, if the measure were in effect currently, the age group that would be most affected by such a change (ages 62-69) would include 21.4% of Latinos who currently report a work-limiting disability, compared to 18.1% of White non-Hispanics.<sup>53</sup>

4. **Impose a tax on Social Security benefits in excess of the value of FICA contributions.** Some propose taxing Social Security benefits similar to the way that pension income is taxed starting in 2004, and phasing out the lower-income thresholds for selected years.<sup>54</sup> About 20% of the actuarial deficit would be eliminated if this measure were implemented.<sup>55</sup> Those most affected by this change would be middle-income retirees, as higher-income recipients are already fully taxed on their benefits, and low-income recipients (about 30% of all recipients) would still not pay a tax on benefits due to deductions and exemptions.<sup>56</sup> **Most Latinos would not be affected by this measure.\***
5. **Increase the taxation of Social Security benefits for recipients who have high income from other sources ("affluence testing").** Currently, beneficiaries are not taxed on their Social Security benefits if their total income\*\* is less than \$32,000 for a couple and \$25,000 for an individual. Those whose total income is above these thresholds are taxed on half of their Social Security benefit, and the tax rate increases as income increases. One proposal is to impose a 10% marginal tax rate on benefits for those earning between \$40,000 and \$49,999, and to increase the tax rate by a set percentage as income rates increase.<sup>\*\*\*</sup> If benefits were reduced for those earning \$50,000 per year or more in this fashion, about 75% of the Trust Fund balance would be restored.<sup>57</sup> Because average annual benefit levels as well as income for Hispanic seniors are low, **this measure would not impact the bulk of Latino beneficiaries.**
6. **Increase the averaging period used in calculating Social Security benefits (for retirees and survivors, not workers with disabilities).** One suggestion has been to raise the weighed 35 years of covered earnings to 38 years, to be phased in between 2004 and 2008 (i.e., raised to 36 for 2004-2005, 37 for 2006-2007, and 38 for 2008 and later).<sup>58</sup> This is

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\* Those who pay tax on these benefits are filing federal tax returns as an individual with total incomes of more than \$25,000 or are filing a joint federal return where the total income is more than \$32,000. Given that 41% of Latino seniors have Social Security as their sole source of income and received a median benefit of \$9,540 in 2002, this proposal would have a limited impact on the Latino community.

\*\* Total income includes adjusted gross income, tax-exempt interest, and one-half of Social Security benefits.

\*\*\* As this plan was proposed in the mid-1990s and has not since been updated, these thresholds would be different if the plan were implemented today.

projected to correct about 12% of the fund imbalance.<sup>59</sup> The burden of this measure would fall hard on low earners as well as immigrants. An increase in the number of years used to calculate the benefit formula would hurt those who come to the U.S. workforce late in life and those with higher unemployment or periods of no work – those more likely to have zeros averaged into their benefit calculations. **Many Hispanic workers, especially foreign-born and women workers, would be deeply and negatively impacted by this measure.** Minorities' benefits would decrease more than Whites' if this change alone were implemented; Black men would experience the largest median percentage decrease in benefits at 4.0%, followed by White-Hispanic men at 3.3% and non-Hispanic White men at 3.2%. Among women, White-Hispanic women's benefits would decrease by 5.0%, compared to 4.2% for Black women and 4.1% for non-Hispanic White women.<sup>60</sup>

There are many variations on these and other benefit reduction proposals that could be debated in the context of Social Security reform. Because the impact of benefit reductions holds the potential to harm low-income seniors disproportionately, policy-makers should be discouraged from moving down this path. Nevertheless, should benefit cuts become a major piece of the Social Security solvency solution, the answer to several key questions are critical. For example:

- How will the measure avoid adding more low-wage workers and low-income retirees to the ranks of the poor?
- How does the measure affect access to Social Security retirement benefits for Latino and other workers?
- What countermeasures, if any, can be proposed to offset adverse impacts on selected workers, especially those who are more vulnerable to work disability?
- How will targeted reductions influence or alter the equity and fairness of the system for selected groups of workers?
- What is the risk that certain benefit reductions could increase perceptions of unfairness in the system?

From a Latino perspective, benefit reduction measures **should not** lessen the level of social insurance that the system provides to the most vulnerable American workers and must take into account the ability of workers to make sacrifices and absorb potential reductions.

### **How Could Policy-makers Increase Revenue?**

Like benefit reductions, there are many ways for policy-makers to increase revenue entering into the Social Security Trust Fund. The critical questions are: Who should pay and how much? How effectively does it address the deficit? What unintended consequences could result from the measure?

1. **Raise the FICA tax rate.** Some have proposed raising the payroll tax rate by 1% of wages, half to workers and half to employers, so that workers and employers would each pay 6.7%. This is projected to eliminate approximately 51% of the imbalance.<sup>61</sup> If the payroll tax were increased by 2%, the Trust Fund's solvency would be completely restored.<sup>62</sup> The payroll tax, however, is a regressive tax, which is burdensome for low-wage workers. With a large share of Latino workers earning low wages, if this measure were enacted alone **Hispanics would be adversely affected.** Moreover, there is a risk that a payroll tax increase at some level would begin to negatively influence overall nationwide employment levels.<sup>63</sup>
2. **Increase or eliminate the maximum taxable earnings limit.** Some experts advocate eliminating or adjusting the cap on taxable wages. In 2005, only earnings up to \$90,000 are subject to the Social Security payroll tax.<sup>64</sup> This is known as the maximum taxable wage base, and it increases each year by the percent increase in average wages. If the cap were completely eliminated, about 77% of the Trust Fund imbalance would be restored.<sup>65</sup> Such a measure would only affect high earners and make the payroll tax more progressive. **Most Latino workers would not be directly impacted by this measure.** However, this would reduce the rate of return on contributions to the Social Security system for many high-wage American workers.
3. **Increase the number of workers who pay into the system.** While most jobs are covered by Social Security, some are not, including many state and local government jobs. One proposal has been to expand coverage to all newly-hired state and local government employees. This would resolve about 10% of the deficit<sup>66</sup> and would only impact state and local workers in selected states such as California, Connecticut, Georgia (certain local governments), Illinois, Massachusetts, Missouri, Nevada, Ohio, and Texas (certain local governments).<sup>67</sup> Though there are many Latinos in these states, Hispanic workers nationwide make up a lower share of government employees. **The impact on Latino government employees would be similar to that on other workers within these states but not disproportionate or adverse on the whole.**
4. **Invest the Social Security Trust Fund in the stock market.** Currently, the Social Security Trust Fund is invested in U.S. Treasury securities. Some argue that the government should hire investment managers to gradually invest (between 2004 and 2018) up to 40% of the Trust Fund in equities in order to get a higher rate of return. Assuming a real rate of return on equities of 6.5%, about 50% of the deficit would be eliminated. With a real rate of return of 5.5%, about 36% of the fund imbalance would be restored. **The impact of this measure would be more or less the same for different groups of American workers, assuming positive rates of return.**



Increasing revenue entering into the Trust Fund rather than reducing benefits may be a more politically palatable means of handling the long-term deficit in the system. Should revenue-raising measures be a principal part of any reform package, several questions are key:

- What effect does the measure have on the tax burden for low-wage workers?
- How might the measure impact the low-wage labor market or overall U.S. economy?
- How would fairness and equity for selected groups of workers be altered by the measure?

Ensuring the long-term solvency of the Social Security system is crucial for Latinos given the importance of the program to those who receive benefits. There are many ways that policy-makers can reduce Social Security benefits or increase revenue. The analysis above is somewhat simplistic given it assumes no other changes or interactions, but it serves as a guide or reference for those interested in how Latinos might fare under certain conditions.

## Private Accounts

In recent years the debate over Social Security reform has become increasingly focused on the question of whether or not to add private savings accounts to the system. Among the arguments in favor, some proponents believe it would encourage personal saving and self-reliance, give individuals more choices, and allow them a chance to get higher returns on tax contributions in exchange for assuming more risks in the stock market. Among the many opposing arguments, many note that the Social Security program was designed as an insurance program rather than a wealth generator. Opponents raise concerns that restructuring the program could undermine the system's basic tenets of guaranteed progressive benefits that are protected against inflation and paid to workers over their retirement years.

Proponents of private accounts have also argued that such a system would be a boon for low-income and minority workers, allowing individuals to own and build assets that can be bequeathed to children or family members. Many proponents of private accounts argue that creating personal savings accounts within the Social Security system is a solution to the challenges that minority workers have had in acquiring wealth. In 2002, the Pew Hispanic Center found that between 1999 and 2001 the Latino net worth fell by more than one-quarter (27%), whereas White households experienced a net worth increase of 2%.<sup>68</sup> As far as median net worth, Latinos have less than ten cents on the dollar relative to White households. Moreover, financial market participation is similarly lacking for Latinos; more than 25% of Latino households own no assets other than a vehicle or unsecured liabilities, compared to 6% of White households in a similar situation. Financial market participation challenges are formidable for Latinos, particularly because one must have a method to save or invest in order to accrue more net worth. In 2002, 26% of Hispanic households had zero or negative net worth, while only 13% of White households faced this challenge, which further indicates Latinos' low participation rates in developing wealth.<sup>69</sup> Clearly, Latinos have faced obstacles in accessing wealth opportunities in the private market.



There have been many various private account proposals developed in recent years. Major plans tend to differ broadly in how the accounts would be financed (existing or additional payroll tax contributions or government funds) and whether participation in the accounts is mandatory or voluntary. Much also depends on the goal of the plan, whether it is to produce enhanced retirement income security or improve wealth levels. Some of these plans would keep the accounts entirely outside of the Social Security system.

The issue of how to finance the restructuring of the Social Security system is a serious challenge for policy-makers and a leading argument for opponents. Transition costs that could escalate into the trillions of dollars over time could have serious and adverse implications for Latinos. It is impossible to evaluate the overall impact of a privatization proposal in the absence of a clear plan to cover transition costs. Nevertheless, the debate can benefit from some analysis of private accounts apart from the financing question. Latino workers and families have a strong interest in both effective social insurance and improved opportunities to build retirement wealth. The debate over private accounts in the Social Security system is relevant and compelling for many Hispanic workers. In view of this, some understanding of how Latinos have engaged in individual retirement savings may illustrate how they would fare under various private account plans. At a minimum, a sense of the current experience of Latino workers can help to pinpoint the critical questions that policy-makers should seek to address in reform plans.

## What Has Been the Experience of Latinos with Individual Retirement Savings?

**P** rivate individual retirement accounts are not a new concept; indeed, they exist in the marketplace currently, but for a variety of reasons many do not work very effectively at increasing overall retirement savings for American workers, especially low-income workers. A snapshot of the experience of Latinos in the private retirement savings market may shed light on the issues and concerns for Latinos within the context of this debate. Overall, the most recent available data reveal that about 31% of Latino families own some kind of retirement account, compared to 52% of all families, and Latinos maintain a substantially lower-than-average median balance in these accounts at \$8,700, compared to \$29,000 for all families.

Other findings are especially relevant such as;

- Latinos are less likely than other workers to choose to participate in employer-sponsored pension plans. In 2003, Hispanics made up the largest percentage of full-time workers without pension plans at 67.4%, compared to 45.9% of full-time workers overall. In the private sector, slightly more than four in ten (41.3%) Hispanic workers had employers that sponsored a retirement plan, but only 32.6% of Hispanic employees participated. For all workers in the private sector, 57.3% had employers that sponsored a retirement plan and 46.7% of the employees were participating, meaning that 81.5% were taking advantage of the opportunity.<sup>72</sup>
- **Hispanic workers have limited experience with financial instruments and maintain relatively low levels of financial knowledge.** One survey found that more than 35% of Latinos did not have a bank account, and this proportion is larger among foreign-born Latinos at 42%.<sup>73</sup> Furthermore, nearly half (46%) of Hispanics surveyed in the University of Michigan Surveys of Consumers reportedly had no regular savings plan.<sup>74</sup> According to the results of a quiz administered with the same survey, only 60% of Latinos said the following statement was true, "With compound interest, you earn interest on your interest as well as your principal," compared to 72% of other respondents.<sup>75</sup> A recent Government Accountability Office (GAO) report points out that their survey found that Hispanics are the least likely to have experience with credit-related products compared to other groups. For example, 62% of Hispanics had experience with credit cards compared to 92% of Whites and 75% of African Americans, and 28% had experience with home mortgages compared to 73% of Whites and 42% of African Americans. These factors can adversely affect Latinos' ability to develop assets.<sup>76</sup> Also, Latino workers were three times more likely than their counterparts (13% vs. 4%) to report lack of understanding about the plan as a reason for non-contribution in an employer pension plan.<sup>77</sup>

- **Hispanic workers tend to have more financial dependents, both in and outside of the household, than other American workers.** Almost three in ten (29%) Latino workers surveyed in 2001 reported being financially responsible for three or more people other than themselves, while the same was true for 21% of all workers surveyed. Furthermore, more than one-third (34%) of Hispanic workers in 2001, compared to 15% of all workers, reported providing "significant" financial support for persons not living in the household.
- **Latinos tend to be more risk averse than other workers.** Data from the 2000 Employee Benefit Research Institute (EBRI) survey found that one in five Latino workers (19%), compared to 10% of all workers, said that the following statement described them "very well": "I am not willing to take any financial risks, no matter what the gain." An additional one-fourth (26%), compared to 18% of all workers, said that this statement described them "well."<sup>78</sup>

Heretofore, most Hispanic workers have not engaged heavily in personal retirement savings and for a variety of reasons are relatively inexperienced with individual retirement savings accounts. In many cases Latino workers have chosen not to participate. Nevertheless, design features of a private account system may differ in significant ways from the private market, influencing participation by Latinos in either direction. For example, while an automatic enrollment feature could enhance participation of Latinos as proven in the private market, a private account-based Social Security system with prohibitions against withdrawals or concerns about risk, fees, and benefit offsets could have the opposite effect.

## Critical Issues Reformers Should Address for Latinos

**F**undamental restructuring of a social insurance system as delicately balanced and as vital to beneficiaries as Social Security raises a number of critical questions of particular interest to Latinos. Given the importance of the Social Security program and experience of Hispanics in the private retirement savings market, proponents of adding private or personal accounts to the system will need to address some critical issues that loom large for the Latino community.

For instance, private accounts that are "carved out" of the current system would add transition costs in the short-term because the system must guarantee the benefits of workers who have paid into the system while some share of worker contributions are moved into a personal account. The transition costs will impose additional revenue demands that need to be considered. For instance, high transition costs could mean diminished capacity in the federal budget for other key Latino priorities such as improvements in education and health care.

Proponents of private accounts should also consider the direct affect on low-income workers, many of whom are Hispanic. Policy-makers would have to investigate the relative options, bearing in mind that low-income workers will have less total money accumulated in an account than other workers. Accounts would need to be designed to minimize risk and find ways to guarantee that such workers benefit at least as much as high-income workers under any restructuring. Certain private account features would be of particular interest to the Latino community, including the following:

- **Progressive account structure.** A benefit formula or account design that is progressive and includes some type of governmental match for Latinos with lower incomes could be beneficial. Social Security currently is weighted to replace relatively more of the wages of low-income workers than high-income workers; maintaining this progressive character in any personal account system would be not only of necessity but also of interest to the Latino community. As Latinos are disproportionately concentrated in lower-paying jobs, the economic realities of low-income workers would have to be addressed in any proposal. Some legislative proposals include a matching feature for low-income workers, but often these plans also allow for individual contributions to the accounts which could only favor those with more disposable income; the result would inevitably be a less progressive system than under current law.
- **Full access to private accounts.** Immigration status bars many Hispanics from participating fully in the Social Security system. Rules and policies that mirror private property rights with respect to status could create a system that is more accessible to Latino workers than under current law. If accounts were available to all workers regardless of immigration status and all contributions would qualify, a private account

system could benefit significant numbers of Hispanic immigrants and their U.S. citizen family members. No current legislative proposal addresses this concern.

- **Individual retirement savings financial counseling.** Meaningful and substantive measures that provide Latinos and other low-income workers – who tend to have limited experience in retirement savings – with individual, one-on-one financial counseling are essential under any personal accounts system. A combination of tax incentives and targeted federal grants could be used to develop an infrastructure that enables low-income workers to access objective and high-quality advice on retirement savings options. Public and private partnerships that involve community-based institutions could be developed to build financial knowledge among Latinos in a more significant way than currently. Senator Graham’s bill offered in the 108th Congress, S. 1878, provides for a financial education effort, but the plan is vague and at first blush seems more symbolic than meaningful.
- **Wealth and ownership guarantee.** If the purpose of a private account is to afford an opportunity for low-income workers to accumulate wealth that can be bequeathed, some insurance will be required. During the payout phase, low-income workers will need to purchase an annuity and account balances will need to be offset against defined-benefits in order to keep the overall system in fiscal balance. Given the likelihood of lower accumulated balances in private accounts for lifelong low-income workers, the likelihood that they will realize a residual balance that can be bequeathed to heirs is relatively lower than for upper-income workers. In order to ensure equal opportunity among workers within the system to attain ownership, some provisions will need to be developed to ensure a minimum residual balance during the payout phase. No current legislation that would carve out personal accounts in the system addresses this concern.
- **Universality.** Finally, the universality of the system must not be undercut through potential leakage of resources prior to the existence of actual social insurance need. Several proposals allow workers who accumulate a given sum in their private accounts to withdraw from or no longer comply with aspects of the Social Security system, provisions which are likely to benefit high- over low-income workers. Though administration and implementation of this provision would likely be expensive and is hardly clear at this stage, it is a provision that would undermine a central aspect of the overall Social Security system.

At the moment, the private accounts policy question has boiled down to whether the accounts should be carved out of, added on to, or established wholly outside of the current Social Security system. Because of the system’s importance to those Hispanics covered by Social Security, but also because a significant number of Latinos are excluded from the system, NCLR welcomes the debate on Social Security reform. Furthermore, because any politically-viable reform proposal will include various tradeoffs, NCLR believes that all

potential policy options should be surfaced and considered. In that context, NCLR's analysis suggests the following:

- **Carve-out accounts.** There are no realistic conditions under which a private account carve-out proposal would benefit Latinos, or low-income workers, to nearly the same degree as upper-income workers. Although it is intellectually possible to construct a private account carve-out system that is fair and beneficial for Latino workers, such a system is unlikely to be developed, enacted, or administered in a way that would maintain the integrity, equity, or social insurance character of the current system. Substantively, a carve-out system would have to address all of the issues listed above (progressive structure, financial counseling, guaranteed residual benefit, full access, and maintenance of a universal structure) as well as shield low-income workers from adverse impacts of revenue-side measures required to maintain solvency. Such a plan would have to make improvements in ancillary benefits (e.g., disability and survivor), increase the minimum benefit on the defined-benefit side, and finance the transition in such a way that would not undermine the ability of Congress to make important domestic investments in the future. Such a system is likely to be politically unpalatable in the short-term, would be enormously expensive to administer, and would likely be the most inefficient means of increasing overall retirement savings. Furthermore, if enacted at a time of enormous fiscal constraint, it is likely to require revenue increases and benefit structures so unattractive to higher-income Americans that the fundamental political support for the entire system might be placed in jeopardy.
- **Add-on accounts.** The notion of an "add-on" account outside of the Social Security system could be beneficial to Latinos. Such accounts could more easily address many of the concerns listed above without threatening to undermine critical aspects of the current Social Security system for Latinos. Accounts for low-income workers could be matched, risk is minimized because the defined-benefit remains intact with no needed revenue offsets, and add-on accounts could produce meaningful ownership of assets with modest extra subsidy. Of course, financing would still have to be addressed, and it is uncertain how this could be accomplished given the current outlook of the federal budget.
- **Retirement savings accounts.** Changes and modifications to existing 401(k) or similar retirement savings vehicles outside the Social Security system could also be beneficial for Latinos. Such changes should be undertaken whether or not a personal account is added to or carved out from the Social Security system. The private retirement savings market should be working more effectively for low-income workers. Proposals to establish automatic enrollment in savings tools, refundable tax credits for retirement savings contributions, and targeted financial counseling could all be included in these efforts. In addition, because these mechanisms would be enacted outside of the Social Security system, various measures could be tested through pilot or demonstration programs, and the question of how to finance widespread implementation could be postponed until the federal fiscal outlook improves.

## Overview of Policy Considerations

**T**he inner workings of the Social Security program are complex and mysterious to most workers and retirees, but from the outside it is accepted as a program that works. It has been one of the most popular and effective government programs for 70 years, which is largely attributable to its social insurance character. The program is the culmination of decades of refinements, modifications, and amendments, all designed to respond to contemporary challenges and emerging public needs. The system has been quite effective as an anti-poverty strategy because of its many progressive features such as base benefit formula, disability and survivor benefits, and cost-of-living adjustments that keep benefits at pace with inflation. At the same time, the program has maintained broad popular support because even the highest-income workers receive a guaranteed benefit that is greater in absolute terms than such workers' contributions to the system.

NCLR seeks to maximize policy outcomes for the growing Hispanic community. This involves maximizing benefits and minimizing costs from any reform proposal within the framework of maintaining the social insurance and universal character of the system. Undermining the central tenets and perceived fairness of the system would threaten the very survival of the Social Security program, and this should be resisted by policy-makers. Policy-makers should also be mindful of the demographics of the Latino community and the importance of this population's contributions to the nation's future prosperity, and be wary of financing measures that would endanger investments in key Hispanic priorities such as education and health care.

No analysis, no matter how exhaustive, could cover every feature or mechanism – or combinations of these – that might conceivably be included in a comprehensive reform proposal. Given that any final reform proposal inevitably will include a series of tradeoffs, each of which would disproportionately affect various demographic groups, it is not possible to predict with any degree of certainty that any single specific feature would be a "deal breaker" for Hispanics. Like every other immigrant constituency involved in the debate, U.S. Latinos will be called upon to weigh the entire package of measures included before deciding whether to support or oppose any specific proposal. That said, NCLR's analysis suggests that any acceptable Social Security reform policy for Latinos must achieve the following:

1. **A stronger, solvent system.** The Social Security program is unquestionably beneficial and important to those Latinos who are included. Because the federal retirement system is progressive, universal, and guarantees a basic benefit for workers, the Social Security program must be made solvent. However, some conventional solvency measures have the potential to impact Latinos adversely and disproportionately. Accordingly, with respect to achieving solvency NCLR:

■ **Insists on:**

- ❖ The inclusion of measures and provisions that shield from or mitigate the negative impact of solvency solutions on low-income workers.

■ **Opposes:**

- ❖ Across-the-board COLA or other reductions that would erode the progressivity of the program and could adversely affect the purchasing power of many seniors, people with disabilities, and survivors who rely on Social Security as a sole source of income.
- ❖ Changes to the benefit formula which increase the number of years factored into the benefit formula.
- ❖ Measures that would further reduce the benefit replacement rates for low-income workers.
- ❖ An increase in the payroll tax rate that does not mitigate the impact on low-wage workers.

■ **Supports:**

- ❖ Lifting the cap on wages subject to Social Security taxation from its current \$90,000 level.
- ❖ Inclusion of state and local workers who are currently out of the Social Security system.

■ **Would consider:**

- ❖ An expansion of the base of revenues subject to payroll taxes outside of wages including investment income and/or an estate tax surcharge.
- ❖ Modest benefit cuts by slowing the growth of benefits for the highest-income seniors.\*
- ❖ Changes to the normal retirement age if accompanied by improvements in the disability insurance program to mitigate the impact on those forced to retire due to disability.

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\* A modest form of price indexing applied to higher-income earners, only unlike Robert Pozen's (the leading plan) progressive price indexing plan because of the negative impact on low- and middle-income workers.



2. **A system that covers more workers, improves access to retirement benefits, and enhances overall benefits for low-income workers.** Social insurance is important and vital to all American workers. The Social Security system must be expanded to cover more Latino workers. As noted above, for a variety of reasons Latinos are less likely than other American workers to qualify for Social Security retirement benefits and receive lower-than-average benefits when they do qualify. Hispanics would also benefit from improved coverage of family members and higher earnings replacement rates. Regarding expansion and benefit improvements, NCLR:
  - **Insists on:**
    - ❖ Expanding coverage by reducing the earnings threshold required for domestic and other itinerant workers to qualify for a quarter of coverage.
    - ❖ Improving enforcement of earnings reporting in selected industries where underreporting is prevalent.
    - ❖ Enhancing or reforming the special minimum benefit (SMB) to ensure that more workers than the 0.3% under current law can benefit, that beneficiaries have incomes above poverty, and that the SMB is targeted to reach those in the population it is meant to serve.
  - **Supports:**
    - ❖ Ratification of the U.S.-Mexico totalization agreement which will also help to extend important insurance coverage to many Mexican workers employed in the U.S.
    - ❖ Reducing the number of years counted to set benefits for selected workers.
    - ❖ Improvements to the disability insurance and SSI programs.
  - **Would consider:**
    - ❖ Measures that would provide quarters of Social Security credit to those who stay home to care for children.
  - **Opposes:**
    - ❖ Measures that would exclude tax contributions of workers when immigrants who are lawfully present apply for retirement benefits.
3. **A system of retirement savings that complements Social Security's guaranteed benefit and enables low-income workers to improve their retirement wealth.** Enhanced retirement savings is an important goal for Latinos which can be addressed through reform. However, the mechanics of how retirement savings options interact with the

Social Security system are important. Accordingly, on broader questions of retirement savings, NCLR:

■ **Insists on:**

- ❖ Expanding, making permanent, and making refundable the Saver's Tax Credit.
- ❖ Allowing for increased administration of automatic features to pension plans (e.g., automatic enrollment).
- ❖ Permitting the splitting of a tax refund, to allow a portion to be invested in an IRA or a savings account and the balance directed to a checking account for immediate needs.

■ **Supports:**

- ❖ The development of private retirement savings accounts in addition to Social Security which: all low-income workers would be eligible for, regardless of immigration status; impose relatively modest costs on the government; and include a governmental or tax-incentive match for contributions and/or an initial lump sum deposit.
- ❖ Strengthening access for low-income workers to financial counselors for the purposes of retirement savings planning.

■ **Opposes:**

- ❖ Private accounts carved out of Social Security.

Obviously, the items above are not an exhaustive listing, but rather an outline of some of the more prevalent options under discussion. There will be policy winners and losers. The Latino community fully recognizes that it must be a part of the solution to the problems facing Social Security. However, any viable reform plan for Latinos must also address some inequities in the system, many already noted above.

Because of the numerous tradeoffs involved, NCLR is committed to analyzing all of the proposals, educating the community about the issues at stake in any proposed reform, and participating vigorously in the debate to ensure that nothing in the system is changed without the input of our community.

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