

# The Future of Social Security: An Overview

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# Summary

1. SS Trust Fund is in relatively good shape compared to the past and projected shortfalls are uncertain—productivity and economic growth could be higher than projected.
2. The private pension system is less stable than SS—low savings, move to DC plans with small 401(k) accumulations and growing pressure on DB plan solvency
3. Huge transition costs to fund privatization (IAs); \$4-5 trillion additional deficit in 20 to 30 years, which could dampen economic growth (higher interest rates).
4. Privatization threatens survivor and disability benefits—no provision to fund them fully.

## Summary (cont'd)

5. The SS wage replacement will fall from 40% to about 29% by 2030 under current law—much lower with privatization.
6. Medicare and Medicaid solvency represent far greater challenges than SS at \$3.7 trillion over 70-75 years, which is one-third the size of the 2001 and 2003 tax cuts.
7. Experience with privatization in other countries reveals limitations—fees, fraud and pension shortfalls (Chile, UK)
8. Privatization would not restore SS solvency—using price rather than wage rates would by reducing initial benefit—by 45+% in 2075.

## Summary (cont'd)

9. The size of retirement benefits from private (individual) accounts depends on stock market performance, which has averaged 6.5% annually for 100 years, but has suffered long periods of stagnation or decline (the 30s and 1969-1982). The current price-earnings ratio (22) is well above historical average (14) which means future returns are likely to average under 5%, which would be reduced further by fees (5 to 15%).
10. Analysis of the most likely privatization plan (Model 2) shows that most retirees would receive less in benefits than under current system in terms of wage replacement rates, if the plan performed as projected by supporters—furthermore, a very substantial new regulatory infrastructure would be required, reductions come from price indexing initial benefit to cover SS shortfall.

## Summary (cont'd)

11. Privatization would not benefit most women and minority retirees (likely hurt) who are dependent on SS benefits for more of their retirement income. Minorities make disproportionate use of survivor and disability benefits.
12. There are several alternatives to privatization as a means of ensuring SS solvency—in fact, privatization alone does nothing to help sustain solvency.
  - The D&O strategy of very slowly increasing payroll taxes and minimally decreasing benefits while improving them for women and minorities.
  - The Robert Ball model of increasing the amount of income to which the payroll tax is applied, using the inheritance tax and increasing the payroll tax in 50 years.

## Summary (cont'd)

13. Greenspan's support for privatization and the crisis campaign supporting it may reflect his concern about the impact of cashing in so many Treasury Bills, from 2018 to 2024 and later, on the value of all financial assets. That concern may be why he supports a substantial reduction in SS benefits (price indexing/raising the retirement age. He does not support repealing any tax cuts.
14. Finally, SS should be analyzed and any changes addressed in the context of retirement security broadly, including private pensions and health care benefits. The four-legged stool for retirement security (savings, DB private pension, health care insurance and Social Security) is in many respects unraveling and all of it needs to be addressed in an integrated fashion—a comprehensive policy fix.

## Summary (cont'd)

15. The future solvency of SS should be addressed in the larger context of retirement security which includes private pensions and retiree health care—more on health care later. I would suggest something like the following as a comprehensive framework.
  - A. Maintain the current SS system and strengthen it by applying the payroll tax to 90% of income (up to \$110,000 currently), and improve benefits for women (provide credits for caregiving). Other adjustments could be made over the next 10-20 years as needed, including use of the estate tax, COLA changes, etc. This approach will give us time to see how current projections play out (economic growth, immigration rates, etc.) and enough time to make needed changes. Making some portion of SS a defined benefit (IAs) program is unnecessarily risky, given the increasing growth of defined contribution plans in the private pension system.

## Summary (cont'd)

B. Gradually implement an IA program as an add-on to the current payroll tax—this program would be carefully managed by the SS Administration to avoid excessively risky investments, prevent pre-retirement payouts and counsel retirees regarding annuities and post-retirement investments. The payroll tax add-on could begin at 1% and rise over time to 2% for a total tax of 14.4% in 20-30 years. This would amount to a government managed universal private savings and investment retirement fund.

## Summary (cont'd)

- C. Strengthen the current private pension system by enhancing 401(k) tax incentives (IRA rollovers) and adequately funding the PBGC program.
- D. Strengthen the Medicare program by improving the drug benefit, adding a long-term care benefit, capping out-of-pocket expenses (now 20%+) and giving age 55-64 retirees a buy-in option and pay for these provisions by reducing tax cuts to the top 20% of income earners (more later).