Disparate Impact
Social Security and African Americans
by Michael Tanner

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Perhaps no group has as much at stake in the debate over Social Security reform as do African Americans. Elderly African Americans are much more likely than their white counterparts to be dependent on Social Security benefits for most or all of their retirement income, yet the current system often works to their disadvantage.

Despite a progressive benefit structure, Social Security benefits are inadequate to provide for the retirement needs of the elderly poor, leaving nearly 30 percent of African-American seniors in poverty. Moreover, because African Americans generally have shorter life expectancies than do whites, they receive less total Social Security payments over the course of their lifetimes.

Social Security also contributes to the growing wealth gap between blacks and whites. Because Social Security taxes squeeze out other forms of saving and investment, especially for low-income workers, many African Americans are unable to accumulate real wealth. And, since Social Security benefits are not inheritable, that wealth inequity is compounded from generation to generation.

Traditional Social Security reforms such as raising the retirement age, cutting benefits, or increasing taxes would only make the problem worse. On the other hand, African Americans would be among those with the most to gain from the privatization of Social Security—transforming the program into a system of individually owned, privately invested accounts.

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Introduction

The debate over Social Security reform is vital to all Americans, but no group has as much at stake as do African Americans. To start with, African-American seniors are disproportionately dependent on Social Security for their retirement income. Three of four older African-American households rely on Social Security for half or more of their retirement income. A third of older African Americans rely on Social Security for all of their income. As a result, they would be among the people most affected by Social Security's looming financial crisis and the potential reduction in benefits that could result.

In addition to the Social Security system's coming problems, African Americans face distinct problems and disadvantages under the current system. Because lifetime Social Security benefits are so closely related to the length of life, African Americans, who have shorter life expectancies, are left at a disadvantage, receiving a far poorer rate of return on their taxes than do comparable whites.

Social Security also contributes to the growing wealth gap between blacks and whites. Because Social Security taxes squeeze out other forms of saving and investment, especially for low-income workers, many African Americans are unable to accumulate real wealth. And, since Social Security benefits are not inheritable, that wealth inequity is compounded from generation to generation.

Any Social Security reform should take into account the needs and circumstances of African Americans. Such frequently discussed reforms as raising the retirement age, reducing benefits, or increasing taxes would only make things worse. On the other hand, privatizing Social Security—transforming the system into one based on individually owned, privately invested accounts—would treat African Americans far more fairly.

The Current System: Unequal Benefits

Lifetime Social Security benefits depend, in large part, on longevity. As a result, people with identical earnings histories receive different total benefits depending on how long they live. Individuals who live to be 100 receive far more in benefits than do individuals who die at 66. Therefore, those groups in our society with shorter life expectancies, such as the poor and African Americans, are put at a severe disadvantage.

As Table 1 shows that, at every age, African American men and women both have shorter life expectancies than do their white counterparts. Although some observers have suggested that this lower life expectancy is income related (lower-income individuals have shorter life expectancies than do wealthy individuals, and African Americans, on average, have lower incomes than whites), the shorter life expectancy of African Americans appears to hold across all income levels.

As a result, a black man or woman earning exactly the same lifetime wages, and paying exactly the same lifetime Social Security taxes, as his or her white counterpart will likely receive a far lower rate of return. Because African Americans have lower average incomes than do whites, they do benefit from Social Security's progressive benefit formula, which generates a higher rate of return for low-wage workers. However, that progressivity is not enough to offset the lower return due to life expectancy. Sylvester Schieber, vice president for research at Watson Wyatt Worldwide and a member of the 1984–86 Advisory Council on Social Security, and John Shoven, professor of economics at Stanford University, examined the effect of race and life expectancy on rates of return for individuals born between 1917 and 1921 and concluded that not only did African Americans have lower rates of return than did whites at every income level but that an African-American worker earning $10,000
A 1996 study by Constantijn Panis and Lee Lillard for the RAND Corporation found that the redistributional effects of Social Security were significantly affected by life expectancy, resulting in a substantial loss to African Americans. African Americans' rates of return were approximately 1 percent lower than those earned by whites. Even adjusting for marital status and income (African Americans' excess mortality is due in part to their lower incomes and lower marriage rates), African Americans earned rates of return half a percent lower than whites. The result was a net lifetime transfer of wealth from blacks to whites averaging nearly $10,000 per person.

A 1998 study by the Heritage Foundation found that African Americans in general, and African-American men in particular, had the lowest rates of return of any group in society. In fact, the study found that an average single black man will pay $13,377 more in payroll taxes over his lifetime than he will receive in benefits, a return of just 88 cents on every dollar paid in taxes. Life expectancy is not the only factor reducing the rate of return that African Americans receive on Social Security taxes. Social Security benefits are calculated on the basis of the highest 35 years of earnings over a worker's lifetime. Workers must still pay Social Security taxes during years outside those 35, but those taxes do not count toward or earn additional benefits. Generally, those low-earning years occur early in an individual's life. That is particularly important to African Americans because they are likely to enter the workforce at an earlier age than whites. Only 13.6 percent of African Americans graduate from college compared to 24.3 percent of whites. Indeed, more than 25 percent of African Americans do not complete high school. As a result, more African Americans

Table 1

<table>
<thead>
<tr>
<th>Age</th>
<th>White Male</th>
<th>Black Male</th>
<th>White Female</th>
<th>Black Female</th>
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<td>75.2</td>
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<td>57.5</td>
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<tr>
<td>15</td>
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<td>52.6</td>
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<tr>
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<td>48</td>
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<td>55.7</td>
</tr>
<tr>
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<td>50.2</td>
<td>43.7</td>
<td>55.6</td>
<td>50.9</td>
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<td>45.6</td>
<td>39.4</td>
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<td>46.2</td>
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<td>35</td>
<td>40.9</td>
<td>35.1</td>
<td>45.9</td>
<td>41.6</td>
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<td>36.4</td>
<td>31</td>
<td>41.1</td>
<td>37.1</td>
</tr>
<tr>
<td>45</td>
<td>31.9</td>
<td>27.1</td>
<td>36.4</td>
<td>32.8</td>
</tr>
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<td>50</td>
<td>27.5</td>
<td>23.4</td>
<td>31.7</td>
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<td>19.9</td>
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<td>60</td>
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<td>75</td>
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<tr>
<td>80</td>
<td>7.3</td>
<td>7</td>
<td>8.9</td>
<td>8.5</td>
</tr>
</tbody>
</table>

enter the workforce early, paying additional Social Security taxes but failing to receive additional benefits.

Some observers suggest that this is offset by gaps in employment later on. African Americans are far more likely than are whites to experience periods of unemployment. However, although African-American men do have more periods of zero earnings during their careers, it does not appear to be enough of a difference to significantly change the disparities in the rate of return. Moreover, there is almost no difference in the number of zero-earnings years for black and white women.8

The lower rate of return is not just an abstract number; it translates directly into lower benefits. For example, assume that a 30-year-old black man and a 30-year-old white man each earns $30,000 per year over his working lifetime. By the time they retire, they will both have paid $136,740 in Social Security taxes over their lifetimes and will be entitled to monthly Social Security benefits of $1,162. However, the white man can expect to live until age 81.10 If he does, he will receive $189,389 in total Social Security benefits. The black man, in contrast, can expect to live only to age 79.11 He can expect to receive only $161,750, almost $27,000 less than his white counterpart.12 This may actually understate the unfairness of the current system, since it is based on life expectancies at age 65. However, if both men are aged 30 today, the life expectancy for the white man is 76; for the black man it is only age 70.13 According to those projections, the black man can

More African Americans enter the workforce early, paying additional Social Security taxes but failing to receive additional benefits.

Figure 1
Real Rates of Return on Social Security


Average Annual Earnings

![Figure 1: Real Rates of Return on Social Security](image-url)
expect to receive nearly $100,000 less in lifetime Social Security benefits than his white counterpart and, indeed, would receive less than half of what he actually paid into the program.\(^1\)\(^4\)

It is this perverse redistribution that has led Ron Walters, professor of political science at the University of Maryland and a leading black activist, to brand Social Security a form of "reverse reparations."\(^1\)\(^5\) It is amazing that this disparate impact, which would not be tolerated in any other government program, is so easily accepted within the current Social Security system.

**The Wealth Gap**

On average, African Americans' incomes continue to trail those of whites. African-American men, as a group, earn only 73 percent of what white men earn, while African-American women earn 89 percent of what white women earn.\(^1\)\(^6\) However, progress is being made, and most of the current inequality can be explained by education and family structure. For example, whereas in 1949 a nonelderly two-parent black family earned only 44 percent of what a white family with similar education and employment earned, today they earn more than 80 percent of what their white counterparts do.\(^1\)\(^7\)

Unfortunately, this progress disguises a much more significant problem: Even as the "income gap" shrinks, the "wealth gap" is growing larger. The typical black household has a net worth of only $4,500. That's less than one-tenth of the figure for whites. More than half of black families have no significant financial assets at all\(^1\)\(^8\) (Table 2).

These figures are distorted slightly because a large portion of white net worth comes from home equity, and whites are more likely than are blacks to own their own homes (although home equity makes up a larger percentage of net worth for blacks than for whites). However, even subtracting the value of homeownership, blacks dramatically trail whites in terms of household wealth.\(^1\)\(^9\)

In addition, African Americans are far less likely than whites to have private pension coverage. Sixty-two percent of whites have pension coverage through their own or a spouse's employment, compared with 54 percent of African Americans.\(^2\)\(^0\) Moreover, participation rates may overstate African-

<table>
<thead>
<tr>
<th>Percentile</th>
<th>Total Net Worth ($)</th>
<th>Financial Assets ($)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>All</td>
<td>African American</td>
</tr>
<tr>
<td>10</td>
<td>150</td>
<td>0</td>
</tr>
<tr>
<td>20</td>
<td>8,000</td>
<td>0</td>
</tr>
<tr>
<td>30</td>
<td>28,005</td>
<td>700</td>
</tr>
<tr>
<td>50</td>
<td>77,800</td>
<td>17,000</td>
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<tr>
<td>70</td>
<td>154,000</td>
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<td>90</td>
<td>384,000</td>
<td>114,600</td>
</tr>
<tr>
<td>95</td>
<td>618,000</td>
<td>182,000</td>
</tr>
<tr>
<td></td>
<td>All</td>
<td>African American</td>
</tr>
<tr>
<td>10</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>20</td>
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<td>50</td>
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<tr>
<td>70</td>
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<tr>
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<td>152,000</td>
<td>11,000</td>
</tr>
<tr>
<td>95</td>
<td>275,000</td>
<td>32,300</td>
</tr>
</tbody>
</table>

American pension coverage because African Americans are somewhat less likely to vest in their plans' benefits. Only 36.8 percent of African Americans are fully vested in their company's pension plan, compared to 41 percent of whites.21

When African Americans do have pension coverage, it is usually a defined-benefit program, not the type of defined-contribution plan that allows for the accumulation of wealth. Roughly 41 percent of white workers are eligible to participate in defined-contribution plans, but only 32 percent of African Americans are offered such programs.22 Even when their employers do offer such plans, African Americans are less likely to participate. For instance, only 53 percent of eligible African Americans participate in their employers' 401(k) plans, while 68 percent of eligible white workers do.23

Most African Americans do not own stock outside of retirement plans. Overall, only about 5.5 percent of black families own stock, compared to 15.3 percent of white families. Approximately 3.5 percent of African Americans own mutual funds; 12 percent of whites do24 (Table 3). As a result, white families are growing wealthier. Black families are not.

Table 3
Percentage of Households Owning Financial Assets, 1995

<table>
<thead>
<tr>
<th>Type of Assets</th>
<th>All</th>
<th>African American</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank account</td>
<td>87.1</td>
<td>69.1</td>
</tr>
<tr>
<td>CD</td>
<td>14.1</td>
<td>5.9</td>
</tr>
<tr>
<td>Savings bond</td>
<td>22.9</td>
<td>11.3</td>
</tr>
<tr>
<td>Bonds</td>
<td>3</td>
<td>0.6</td>
</tr>
<tr>
<td>Stocks</td>
<td>15.3</td>
<td>5.5</td>
</tr>
<tr>
<td>Mutual funds</td>
<td>12</td>
<td>3.5</td>
</tr>
<tr>
<td>Retirement account</td>
<td>43</td>
<td>29.2</td>
</tr>
<tr>
<td>Life insurance</td>
<td>31.4</td>
<td>24.4</td>
</tr>
<tr>
<td>Any financial asset</td>
<td>90.8</td>
<td>77.4</td>
</tr>
</tbody>
</table>


There is no single reason why African Americans invest at lower rates than whites, but Social Security is a contributing factor. Participation in voluntary savings and investment arrangements is highly dependent on income.25 For low-income workers, the primary reason for lack of savings is not a lack of incentives but a lack of disposable income. After paying daily living expenses, they simply have no funds left over to invest. Given that African Americans, on average, have lower incomes than whites and are disproportionately represented among low-wage workers, it is not surprising that they have lower rates of saving and investment.

They are, however, required to pay 12.4 percent of their income into Social Security. This extracts a terrible opportunity cost, because the money they are forced to pay into Social Security, with its poor rate of return and lack of personal ownership, is money that they could otherwise invest in real assets—assets that they would own and that would earn far higher returns.

This last point is especially important. African Americans are, in essence, being forced to substitute Social Security "wealth" for other types of wealth. But Social Security is not
wealth in any traditional sense. A person does not own it. There is no legal property or contractual right to that wealth. It is merely a political promise that may or may not be kept.

Moreover, Social Security is not inheritable. Unlike other forms of wealth, it cannot be passed on to future generations. Numerous scholars have stressed inheritance as a means of increasing wealth in the African-American community and the role that the lack of such inherited wealth plays in widening the black-white wealth gap. Darrell Williams, professor of economics at the University of California at Los Angeles, calls inheritance “the single biggest factor that explains the wealth gap.” But, as Jagadeesh Gokhale, an economist at the Federal Reserve Bank of Cleveland, and others have noted, Social Security essentially forces low-income workers to annuitize their wealth, preventing them from making a bequest of that wealth to their heirs.

Moreover, because this forced annuitization applies to a larger portion of the wealth of low-income workers than of high-income workers (in this case a larger proportion of black income than white), it turns inheritance into a “disequalizing force,” leading to greater inequality of wealth in America. The wealthy are able to bequeath their wealth to their heirs, while the poor cannot. The wealth gap has an impact beyond individual families; it helps to impoverish entire communities.

Most economists recognize that when investment capital grows scarce the areas that are the first to feel the lack of capital are areas where investments are most risky—inner-city neighborhoods with high crime rates, a poorly educated workforce, and high business bankruptcy rates. As economist Jude Wanniski explains, “The people who lose the most . . . are the poorest, the youngest, those at the beginning of their careers, those who are furthest from the sources of capital.”

Social Security has the perverse result of transferring capital out of areas where it is needed most, such as the inner city, to comfortable retirement communities. The South Bronx loses; the Florida coast gains.

The Current System: Inadequate Benefits

Without other assets to rely on in retirement, African-American seniors are disproportionately forced to rely on Social Security for their retirement income. Unfortunately, Social Security benefits are quite low, leaving 3 of 10 African-American seniors in poverty.

Perhaps the easiest way to look at this is to examine Social Security’s “replacement rate,” or the proportion of a person’s preretirement income that Social Security benefits equal or replace. Because of Social Security’s progressive benefit formula, the program’s benefits replace a higher proportion of income for low-wage earners than for high-wage earners. The actual replacement rate fluctuates slightly from year to year on the basis of a variety of factors. For an average-wage earner who retires this year, Social Security can be expected to replace approximately 42.4 percent of preretirement income. A low-wage worker will receive benefits equal to 57.1 percent of preretirement income, and the replacement rate for a high-wage worker will be 25.6 percent.

For people who are 25 years old today and will retire in 2037, projected replacement rates are 55.7 percent for low-wage workers, 41.5 percent for average-wage earners, and 27.5 percent for high-wage earners. However, the relatively higher replacement rate for low-wage workers should be considered in light of their greater dependence on Social Security. Low-wage workers depend on Social Security for 81 percent of their income. Thus, total annual retirement income for the 25-year-old low-wage worker (from Social Security and other sources) will equal only 69 percent of preretirement income. In comparison, Social Security accounts for only 20 percent of postretirement income for high-wage earners. Therefore, when a high-wage worker retires,
his income will actually equal 138 percent of his income before retirement despite the lower replacement rate.

Most financial planners suggest that if one’s preretirement standard of living is to be maintained, retirement benefits of between 60 and 85 percent of preretirement income are probably necessary. [32] Clearly, then, Social Security fails to provide sufficient income to afford poor workers a dignified and secure retirement.

A Bad Situation Will Get Worse

As unfair as Social Security currently is to African Americans, the situation will soon get worse. Social Security faces an unfunded liability of more than $21 trillion. By 2015 the program will begin to run a deficit. At that point, Social Security will be forced to either reduce benefits or increase taxes. Either of those choices will severely impact African Americans. [33]

The payroll tax is an extremely regressive tax. First, it is a tax only on wages, leaving other income sources, such as capital gains, interest, profits, gifts, inheritances, and other types of investment income, untaxed. Since wages represent a higher proportion of African Americans’ income, a payroll tax will take a higher percentage of total income from blacks than from whites. This effect is compounded because the amount of income subject to the payroll tax is capped. Therefore, wealthy individuals actually pay a smaller percentage of their total income in payroll taxes than do poor workers.

Under the SSA’s intermediate projections, in order to continue paying all promised benefits, the combined employer-employee OASDI portion of the payroll tax would have to be increased from the current 12.4 percent to more than 19 percent. That would push more working blacks into poverty.

Likewise, as we have seen, a reduction in benefits will also disproportionately hurt African Americans since elderly blacks are more likely than elderly whites to be poor and, therefore, dependent on Social Security benefits. Those poor elderly who receive most or all of their retirement income from Social Security can ill afford any reduction in benefits. Yet benefit cuts of as much as one-third may be required to keep the system solvent. A one-third reduction in Social Security benefits would leave the elderly poor with a postretirement income equal to only 50 percent of their preretirement wages. Such a benefit cut would plunge millions of elderly African Americans into poverty.

Reducing benefits indirectly by, for instance, raising the retirement age would also work to the severe disadvantage of African Americans because of their shorter life expectancies. Few would live long enough to see even a single Social Security benefit check.

The Solution: Privatize Social Security

Although African Americans are disadvantaged under both the current Social Security system and many of the most commonly discussed solutions to the program’s future financial crisis, they would be among those who would benefit most from Social Security privatization.

First, by transforming Social Security from a defined-benefit to a defined-contribution plan, privatization would disconnect total benefits from life expectancy. The benefits an individual received would depend on what was paid into the system plus the investment return on those payments, not on how many years the person received benefits.

In addition, individuals who begin work earlier, and therefore contribute for additional years, would earn additional benefits as a result of their contributions.

Moreover, under a privatized system, individuals would have a property right to their Social Security benefits. If a person were to die with money still in his or her retirement account, that money would become part of the estate to be inherited by that person’s heirs.
The importance for African Americans of this inheritance right cannot be overstated. The ability to accumulate wealth and pass that wealth on to one's heirs is critical to the future of black-white equality. If African Americans are going to be full partners in the American economy, the "wealth gap" must be closed. African Americans must become investors. After all, as both Jesse Jacksons say, "Capitalism without capital is just an 'ism.'"* Privatizing Social Security would give low-income workers in general, and African Americans in particular, a chance to accumulate that capital.

There are more immediate advantages to privatization as well. Not only would a privatized Social Security system provide a fairer rate of return to African Americans, but that rate of return would be far higher, lifting many African-American seniors out of poverty. Figure 2 shows the difference in the rate of return that African Americans receive under Social Security and what they could expect to receive from private capital investment.*

The increased rate of return translates into higher lifetime benefits. However, if you ignore the impact of life expectancy and look only at monthly retirement benefits, private capital investment still leaves African American seniors far better off. As Figure 3 shows, even low-income African-American seniors would receive significantly higher benefits under privatization.

The higher retirement benefits under privatization would lift many African-American seniors out of poverty. A new study by Harvard professors Martin Feldstein and Jeffrey Liebman (a former Clinton adminis-

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Figure 2

Comparative Rates of Return on Social Security and Private Investment for Selected Categories of African Americans

![Chart showing comparative rates of return for different categories of African Americans.](chart.png)

Conclusion

Our current Social Security system contains a great many inequities. Minority groups, such as African Americans, are among those who are most disadvantaged by Social Security. Elderly African Americans are much more likely than their white counterparts to be dependent on Social Security benefits for most or all of their retirement income. But despite a progressive benefit structure, Social Security benefits are inadequate to provide for the retirement needs of the elderly poor. As a result, 3 of 10 elderly African Americans live in poverty.

In addition, the nominal progressivity of Social Security is undermined by differences in life expectancy. Because African Americans generally have shorter life expectancies, they receive less total Social Security payments over the course of their lifetimes than do whites. In effect, Social Security transfers wealth from poorer blacks to wealthier whites.
wealth from poorer blacks to wealthier whites. It seems unlikely that this inequity would be permitted to continue in any other government program.

Finally, because Social Security taxes squeeze out private savings and investment, they make it more difficult for African Americans to accumulate wealth. The result is a growing wealth gap, with African Americans falling further and further behind.

Therefore, African Americans are among those with the most to gain from the privatization of Social Security—transforming the program into a system of individually owned, privately invested accounts, similar to individual retirement accounts or 401(k) plans. A privatized Social Security program would provide poor African-American retirees with higher benefits, would not be dependent on life expectancy, and would increase the pool of capital available for investment in poor inner-city neighborhoods.

African Americans understand this and are increasingly coming to embrace Social Security privatization. According to a Zogby International poll conducted for the Cato Institute, African Americans support privatization by a margin of 58 to 30 percent. Other polls show similar results.

Everyone interested in racial equality in America should recognize that Social Security privatization is rapidly becoming a civil rights issue. In its own way, privatizing Social Security will do as much for future generations of African Americans as ending Jim Crow did for past generations.

Notes


6. One of the earliest works to address this problem was Milton Friedman and Wilbur Cohen, Social Security: Universal or Selective? (Washington: American Enterprise Institute, 1972).


9. Counting only the Old Age and Survivors Insurance portion of the payroll tax. This figure does
not include the disability portion.


11. Ibid.


14. This type of analysis has been criticized for failing to include the impact of survivors’ and disability benefits, both of which are received by disproportionate numbers of African Americans. However, there are no empirical studies to support this contention. Indeed, when the 1996–98 Social Security Advisory Council asked the Social Security Administration to conduct such a study, the SSA refused. Scheiber and Shoven, p. 227.


24. McCall.


31. House Committee on Ways and Means, Overview of Entitlement Programs, 2000 Green Book: Background Material and Data on Programs within the Jurisdiction of the Committee on Ways and Means, Committee print, 2000, Table 1-17.


35. Some opponents of Social Security privatization have argued that such rate-of-return comparisons are misleading because they fail to account for transition costs. See, for example, John Geanakopolis, “Generation X: Does Bush Understand His Social Security Plan?” New Republic, October 23, 2000, pp. 18–20. They point out that the rate of return is the ratio of how much a person pays in to how much he actually gets out. Therefore, any measure of the return must take into account not just the amount paid into private investment but also anything paid to continue providing benefits to
current beneficiaries. Consider a simple overlapping-generations model describing Social Security: Generation A’s benefits are paid by Generation B, B’s by C, and so forth. Imagine that generation C wishes to privatize. To be able to invest its own payroll taxes in the market, generation C must also cover B’s benefits. Imagine that generation C does so at a 5 percent rate, while investing its own money at a 7 percent rate of return. The net gain is only 2 percent—the 7 percent gain from investment minus the 5 percent interest to service the money borrowed. And, in a properly functioning market, the 2 percent differential will be purely a function of risk. Therefore, there is no real gain to generation C. Moreover, the debt would never end. The 5 percent interest rate cited is purely for servicing the debt, not for repaying it. Thus, it is arguable that no one ever receives a higher rate of return under privatization.

This argument is correct as far as it goes. Privatization is not simple arbitrage, and all costs must be taken into account. However, the critics are mistaken in assuming that all methods of paying those costs are the same. If, for example, the costs were paid purely through an increased payroll tax, the critics would be correct. Workers would see no increase in their rate of return. But if the transition is financed by cutting government spending, that is a different story. Most economists would agree that government makes far less productive use of capital than does the private sector. In many cases, government spending is actually harmful to the economy, producing, in a sense, a negative rate of return. Therefore, cutting government spending to fund the transition would not entail a loss in current welfare equivalent in present value to future gains in welfare.

In short, the critics are correct to note that the transition to a privatized system ultimately requires an increase in national savings. If we wish to support a larger retiree population in the future, the only choices are to redistribute wealth to the old at the expense of the young or to increase economic output so that both groups can be made better off. Increasing savings is the most straightforward way to increase future economic output. All things being equal, therefore, the cost of the transition is simply the cost of increased savings. In order to increase savings, someone must forgo consumption today. The critics imply that that someone must be the individual worker. However, under a properly structured privatization scenario, it would be the government that forwent consumption. Hence, workers would be better off because they would receive a higher rate of return.

Two other points should be made. First, if the transition were paid for by taxes rather than reductions in government spending, it would far more likely be paid for out of income taxes than out of payroll taxes. Because the income tax system is highly progressive, low-wage workers would see the full rate of return from their individual accounts, there being little or no offsetting increase in their income taxes, while high-income workers would bear most of the cost and see reduced rates of return. An income-tax-funded transition would be a large transfer from today’s wealthy to both today’s poor and workers of the future. Thus African Americans would clearly benefit.

Finally, we should recognize that we are currently in an era of unified budget surpluses. Those surpluses have been largely unforeseen and uncounted upon—a windfall. Therefore, while using the surplus to fund the transition would technically have the same economic effect as funding the transition with increased taxes, the effect on the utility of today’s population would be small. Moreover, this does not consider the likelihood that, in the absence of using the surplus to pay for the transition, the money would be spent on new government programs.


37. Poll of 1,205 likely voters nationwide conducted July 29–August 2, 1999. One hundred forty African Americans were included in the sample, 11.7 percent of the entire sample. The margin of error is +/- 3.0 percent.