

LEADERSHIP COUNCIL  
*of*  
AGING ORGANIZATIONS

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*Barbara B. Kennelly, Chair*

## Social Security Privatization

### What is being proposed?

A **privatized system of individual investment accounts** would radically change the structure of the Social Security system from one with guaranteed benefits to one based partially or fully on individual investment accounts in which individual workers would bear risk. By diverting some or all of current Social Security revenues into individual investment accounts, such proposals would enlarge the system's projected shortfall and require big benefit cuts, tax increases or more government borrowing. The Leadership Council of Aging Organizations would oppose this approach.

### What would a privatized system of individual investment accounts mean?

Privatization undermines the basic structure of Social Security. Diverting just a portion of workers' Social Security contributions into individual investment accounts means cutting back on Social Security's family protections. Social Security was designed to insure workers and their families against the financial loss and devastation that can come with retirement or the untimely death or disability of a worker. It is the foundation of family economic security. Beneficiaries receive a guaranteed source of monthly income regardless of the ups and downs of the economy or the stock market.

Also, Social Security's benefit formula adjusts to the specific circumstances of recipients. For example, the family of a worker who dies or becomes disabled will receive a larger benefit than a single worker would receive. For a worker who has always had low earnings, the benefit formula is weighted to replace a higher percentage of those earnings. Benefits carry a guarantee that they will never run out and are fully adjusted for inflation so that they maintain purchasing power.

Individual investment accounts undermine these comprehensive family protections. An individual account pays out only what has been accumulated. It does not provide benefits tailored to meet a family's long-term needs, particularly when a worker dies or becomes disabled at an early age. An individual account's value will fluctuate greatly with changes in the economy and financial markets. Unlike Social Security benefits, an individual account can't guarantee income in bad times, nor can it guarantee protection against inflation. It does not ensure that workers who have labored a lifetime in low-paying jobs will have a secure base at retirement. And it does not guarantee that individuals will have income to last a lifetime.

**Privatization requires huge changeover costs.** An individual investment account system funded with Social Security contributions equal to just 2 percent of workers' earnings means that the Social Security system will lose more than \$1 trillion in revenue over its first decade and much more in later years. It leaves Social Security underfunded because that money won't be available to pay benefits. As a result, taxes would have to be raised, benefits would have to be cut or the government would have to borrow more. This is true regardless of whether individual accounts are mandatory or voluntary.

**Privatization puts survivor and disability protections in jeopardy.** Diverting money out of the Social Security system into individual investment accounts could require substantial

reductions in survivor and disability benefits. Since revenues diverted from the Social Security Trust Fund would no longer be available to pay guaranteed benefits, those benefits might have to be reduced significantly. This is a critical issue that has been largely ignored by proponents of individual investment accounts.

Today, workers who become disabled or die can rely on Social Security for a basic income for themselves and/or their families. This is true even for younger workers who have not had many years to pay into the system. But if any part of Social Security were replaced with individual investment accounts, workers who die or become disabled and their families would face greatly reduced guaranteed benefits and would be forced to rely on their own investments to make up for the lost income. If they are young and have not had sufficient time to accumulate funds in their personal accounts, workers could be putting their families in serious jeopardy. Social Security disability and survivor benefits frequently involve payments to multiple family members, which makes it even more difficult for the income from an individual account to pay the same level of benefits.

**Privatization means a bleaker future for low- and moderate-wage earners.** While the Social Security benefit formula rewards higher earners with larger benefits, it also replaces a larger proportion of low earners' wages at retirement, disability and death. This progressive mechanism is vital to maintaining Social Security's function as an anti-poverty program for all elderly and disabled persons and surviving family members. Social Security is particularly important to older women living alone and minorities. Four in ten older women living alone and half of African American and Latino elderly rely on Social Security for at least ninety percent of their income.

Privatization could destroy the progressive nature of the Social Security program. In a system of private accounts, low-wage workers would have less to invest than high earners, and less opportunity to accumulate sufficient returns for their retirement years.

**Privatization would be especially harmful to women and minorities.** Social Security benefits are particularly important to populations not well served by other income replacement programs, such as women and people of color. The cuts in guaranteed benefits required by diverting Social Security revenues into individual accounts would be particularly devastating for these groups.

On average, women have lower incomes and less money to invest than men. They are less likely than men to receive pension benefits. Women interrupt their working careers more frequently for family caregiving duties. And they live longer. Under a system that's based even partly on individual investment accounts, women would risk outliving the assets in their accounts. Also, divorced women rely on specially designed benefit protections in Social Security-protections that would be difficult to address with an individual investment account.

Like women, African Americans and Latinos are less likely to have resources other than Social Security when they retire, become disabled or die leaving dependent family members. Currently, 26 percent of African American seniors and 21 percent of Latino seniors live in poverty. These numbers would undoubtedly increase under a system of individual accounts. Most private individual account proposals raise the retirement age, which would disproportionately harm African American men because they have shorter life expectancies than the general population.

**Individual accounts are expensive to administer.** Costs would include investment management fees, brokerage commissions, record-keeping fees and various transaction fees plus profit margins for all of the private companies involved in administering individual accounts. These would reduce investment returns considerably. Reduced returns would have the harshest impact on lower-paid workers, who would have smaller accounts and be

less likely to have employer-provided pensions and personal savings.

**Individual accounts are uncertain.** Social Security provides benefits that are predictable and reliable. Privatization would replace all or part of these guaranteed benefits with individual investment accounts that are inherently uncertain. Market returns are not guaranteed—they fluctuate dramatically from individual to individual and from year to year. While the stock market rose to new heights in the 1990s, history and recent events prove that soaring markets don't go up forever. Eventually the market drops, and it usually takes time to rebound from a steep decline. Stocks did not regain their 1929 highs until 1954, and it took almost ten years for the market to match its 1973 high point. Similarly, not everyone earns the market average—some do better, others do worse.

It's easy to imagine the impact of recent stock market declines, corporate bankruptcies and executive malfeasance on a privatized Social Security system. One need only look at the devastating effects on 401(k) plans and similar workplace savings programs to see how individual accounts carved out of Social Security might fare. With the decline of traditional defined benefit pensions in favor of defined contribution plans, much of retirement savings is already tied to private investments. A prudent person would have to question the wisdom of adding Social Security to this individual-investment mix, when it would clearly put at risk the one source of income that is currently risk-free.

Finally, privatization proposals rely on the notion that individual accounts can generate returns high enough to ensure adequate retirement income. This is based on future economic predictions much rosier than those used to forecast the Social Security system's long-term solvency. If the economy grows at the rate privatization proposals assume, Social Security would have more than enough revenue to fund all of its benefit obligations indefinitely.