LATINOS & SOCIAL SECURITY

RESEARCH REPORT

NO. 2
JUNE 2007

Published by

UCLA Center for Policy Research on Aging

USC Ethel Percy Andrus Gerontology Center

UCLA Chicano Studies Research Center

In partnership with

the National Hispanic Council on Aging

and the National Association of Latino Elected and Appointed Officials

This project is made possible through a grant from the Ford Foundation

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SOCIAL SECURITY REFORM
How Various Reform Options Will Affect Latino Retirees

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Since the first benefit check was issued in 1940, Social Security has substantially improved the economic well-being of millions of Americans. Without Social Security, about half of all older adults would live in poverty (Furman 2005). As a group, Latinos are particularly reliant on Social Security.[1] The Social Security Administration (SSA) has indicated that a large percentage of elderly Latino married couples (39%) as well as unmarried persons (58%) receive at least 90% of their income from Social Security (2004a). Because a high proportion of Latino elders lives in poverty—22% compared to 10% for the U.S. population as a whole—or near poverty (Beedon and Wu 2004; Mutchler and Angel 2000), Latinos are especially vulnerable to proposed reforms that would change either the structure of Social Security or reduce the amount paid to beneficiaries. This report, the second in a series on Latinos and Social Security, examines the impact that different proposals to change Social Security will have on Latino elders. These reforms, which have been suggested by various sources, call for changes that range from relatively modest alterations to major restructuring. In addition to describing and analyzing the reform options, this report provides a brief overview of Social Security and the problems driving the reform agenda.

Setting the Stage for Reform

Social Security consists of two trust funds, Old-Age and Survivors Insurance (OASI) and Disability Insurance (DI). The program is primarily pay-as-you-go, which means that payroll taxes from current workers are used to fund those receiving benefits. However, to cover projected increases in the number of beneficiaries when successive waves of baby boomers retire, the program is building a surplus. According to the most recent OASDI Trustees' Report (Social Security Administration 2006), the Social Security Trust Funds showed a surplus of $181 billion in 2005 ($702 billion in income, less benefits paid of $521 billion). Starting in 2008, the first of the baby boom cohort—those seventy-six million individuals born between 1946 and 1964—will begin to turn sixty-two, making them eligible to receive early retirement benefits.[2]

The current debate on Social Security reform is occurring in response to potential problems relatively far in the future. According to the SSA, expenses will exceed income for the combined OASDI Trust Funds beginning in 2017 (Social Security Administration 2006). Under intermediate assumptions, it is projected that the surplus is sufficient to pay full benefits until 2040, at which time the combined Social Security Trust Funds are expected to be depleted.[3] Then, if no changes are made, Social Security will be able to pay at a rate of about 74% of the projected benefits (Social Security Administration 2006). While most believe that some combination of solutions is necessary to ensure actuarial soundness for the long-range seventy-five-year valuation period used for Social Security, many authors emphasize that it is important to maintain the guiding value of protection on which the system is based (e.g., Ball 1998; Herd and Kingson 2005). Specifically, Social Security is based on the principle of serving national and individual interests to ensure adequate income in retirement and to provide protection against loss of income due to the death or disability of a wage earner. Elimination of the progressive benefit structure, which modestly redistributes resources from high to low lifetime earners, would deviate from the core principle of protecting workers and their survivors from economic crisis.

Proposed Reform Options

Government personnel, scholars, and policy experts have proposed a number of options to improve Social Security's long-range actuarial balance. Most involve adopting incremental changes, which has been the approach to reform since the inception of the program in 1935. For example, in 1983, when Social Security faced a much more immediate financing crisis (Arnold 1998), the remedy involved sharing the pain among those paying in, those receiving benefits, and new groups of enrollees (Light 1995). As with the many times that the Social Security Act has been amended, adjustments made to the Social Security system by the bipartisan Greenspan Commission, a committee appointed to propose solutions for returning Social Security to financial viability, "bolstered, rather than revamped Social Security" (Marmor and Mashaw 2002, 175).

This report considers several approaches to reform Social Security that are at the forefront of public debate. These options would have varying effects on Latino elders. Building on and adding to reform options delineated by AARP (2005), Table 1 groups proposals into three types of approaches to restore the long-term viability of Social Security: those that increase the amount paid in by workers, those that reduce the amount paid to beneficiaries, and other, more "out of the box" strategies. The table provides reform options on the left and a corresponding percent on the right representing the percentage of shortfall this reform would correct. As the data show, a combination of options is necessary to bring the Social Security system into long-range balance. However, as noted by Chaplain and Wade (2005), the percentages provided are not discrete figures that can be added together; because the options frequently overlap, their combined effects may be slightly less than would otherwise be expected. Additionally, it is important to keep in mind the ultimate reform objective when considering these options. As the

TABLE 1. Selected Proposals to Reform Social Security

Reform Options	Percent of Solvency Target Achieved by Enacting Option[1]
Approaches that increase the amount workers pay into Social Security	
• Make 90% of earnings subject to payroll tax over 10 years and maintain at that level	43
• Raise amount of earnings subject to Social Security payroll tax to $120,000 and subject earnings over $120,000 to a 3% surtax	50
• Cover newly hired state and local government workers	11
Approaches that reduce the amount paid to beneficiaries	
• Reduce the annual cost-of-living adjustment (COLA) by 0.5 percentage points	42
• Calculate the annual cost-of-living adjustment (COLA) using the more accurate Chained CPI-U in place of the current CPI-W	19
• Increase benefit computation period from 35 to 38 years, phased in over five years	14
• Accelerate the current increase in full retirement age to 67 and index future retirement age to longevity, up to age 70	36
• Tax Social Security like private pensions	17
Other strategies	
• Invest 15% of the Social Security Trust Funds in equities, phased in over 15 years, at an assumed 6.5% inflation-adjusted rate of return	13
• Convert residual estate tax to a dedicated Social Security tax	27
• Partially privatize Social Security by creating individual investment accounts	N/A[2]
• Use means testing to determine Social Security benefits	Varies

Source: adapted from AARP 2005, 20. Additional sources: Aaron and Orszag 2004; Alley, Wilber, and Bengtson 2005; Altman 2005; Chaplain and Wade 2005.

[1] The solvency target used is 1.89% of taxable payroll, the projected actuarial deficit from the 2004 Trustees' Report (Social Security Administration 2004b). Although this estimated deficit has increased modestly, most reform proposals are based on the 2004 figure.

seventy-five-year actuarial projections made by the trustees are vulnerable to unexpected fluctuations in contributing factors, a commonly accepted goal is to obtain "close actuarial balance"—that is, getting within 5% of balancing revenue and expenditures—as the actuarial endpoint. Thus, based on estimations using the 2006 Trustees' Report (Ball 2006), it is only necessary to achieve 58% of the solvency target used in Table 1 to reach close actuarial balance.

Increasing Worker Contributions

Several options would increase money paid into the Social Security Trust Funds by increasing the amount that some workers contribute or by expanding the number of workers paying in. OASDI's funding comes almost exclusively from the payroll tax. Employees and employers each contribute a percentage (6.2%) of the worker's pay, up to a ceiling or maximum amount of $97,500 (in 2007). One option is to increase this ceiling by making 90% of national earnings subject to the payroll tax. Since the 1983 reform, the maximum taxable earnings base has increased in a manner that keeps the highest 6% of earners at or above this level. However, changes in income distribution have meant that while this top 6% earned only 10% of the national income in 1983, their share of earnings had increased to 15% in 2002 (Diamond and Orszag 2004). This change would return the maximum taxable earnings base to the percentage established by the 1983 reform. This increase would take effect progressively over ten years, with the share of national income subject to Social Security's payroll tax remaining at 90% thereafter.

A second and related option would raise the amount of earnings subject to the Social Security payroll tax to $120,000 and subject earnings over the $120,000 ceiling to a 3% surtax. This surtax, described as a "legacy tax," would help cover the imbalance in the Social Security system known as the "legacy debt," a result of the deficit that occurred when benefits paid to the early Social Security beneficiaries far exceeded the value of their contributions (Aaron and Orszag 2004). This generous policy was due, in part, to the need to jump-start Social Security in its early years by paying benefits to retirees even though they had not paid into the Trust Fund for the required forty quarters. Because early cohorts received much more in benefits than their contributions had financed, there are fewer resources for later cohorts compared to the contributions they have made (Diamond and Orszag 2004).

In contrast to asking certain workers to contribute more, the third approach adds more workers to the pool of Social Security participants. Currently, because state and local government workers are not required to participate in the Social Security system, about 25% do not pay into the program (Altman 2005). This reform option would require all newly hired state and local workers to participate in Social Security.

Reducing Beneficiary Payments

Instead of increasing worker contributions, several proposals suggest lowering the amount paid to beneficiaries. The first proposes to change the formula used to calculate the cost-of-living adjustment (COLA). Since 1975, an annual COLA, based on increases in the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W), has protected the purchasing power of Social Security benefits. COLAs are automatic annual increases in monthly Social Security benefits that prevent the inflation-induced erosion of benefits (Social Security Administration 2005b).

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Because some experts contend that the CPI-W overestimates increases in the actual cost of living, one recommendation is to base annual increases in Social Security on an alternative measure, the Chained CPI-U (derived from the CPI-U, the Consumer Price Index for All Urban Consumers; see Aaron and Orszag 2004). The Chained CPI-U is considered a more accurate measure of inflation than the CPI-W, as it takes into account consumers' tendencies to change their buying habits when prices of certain goods increase (Altman 2005). This change would modestly reduce benefits in the near term and have a compound effect over time, saving more money downstream but also decreasing the amount beneficiaries receive. Alternatively, some recommendations call for reducing the COLA by a fixed percentage rather than changing the basis of the COLA calculation. For example, Chaplain and Wade (2005) suggested reducing the COLA by 0.5 percentage points, a substantial reduction since the average COLA over the past decade has been just over 2.52% (Social Security Administration 2006). This approach would have a greater and more immediate impact than the Chained CPI-U and would also decrease potential benefits in a compound fashion over time.

Another approach that would reduce benefits is changing the benefit computation period. Although the minimum work time required to be eligible for Social Security is forty quarters (ten years), Social Security payments are based on an individual's earnings in all employment covered by Social Security. To compute benefits, the SSA averages the thirty-five years in which a worker's inflation-adjusted earnings were the highest. For the purpose of this calculation, the SSA assigns a value of zero to any years in which the worker had no earnings (Diamond and Orszag 2004). For example, an individual with a more intermittent work history will have a lower benefit than an individual with a longer, more regular work history at the same pay rates. This reform proposal suggests raising the benefit computation period from thirty-five years to thirty-eight years.

In addition to changing the benefit computation period, proposals have included increasing the age of eligibility for full Social Security benefits. This eligibility age is the baseline that the SSA uses when calculating initial benefits; a worker who retires before the full eligibility age will receive reduced benefits, whereas a worker who retires after the full benefit age will receive a larger benefit check. As described above, changes to the Social Security program in the 1980s raised the eligibility age for full retirement benefits from age sixty-five to sixty-seven. This change began in 2000 for those born in 1938 and will end in 2022 at a maximum age of sixty-seven for those born in 1960 or later (Social Security Administration 2006). The proposed reform would speed up the conversion to sixty-seven and gradually increase the age of full retirement from age sixty-seven to seventy.

Other proposals would change the way in which Social Security is taxed. Since the 1983 reform, Social Security has been taxable if beneficiaries have incomes above $25,000 for a single individual and $32,000 for a married couple filing jointly (Beedon and Shelton 2001). In 2000, about one out of three beneficiaries, over fourteen million people, paid taxes on their Social Security income. Some analysts have suggested taxing Social Security like private pension income, meaning that those benefits that exceed contributions would be taxed like other income. Based on existing tax provisions, this would mean that about two-thirds of Social Security beneficiaries would pay income tax on their benefits (Walker 2005).

Other Strategies for Reform

As an alternative to incremental reform, several approaches suggest more substantive changes to Social Security. One such reform proposes to use the residual estate tax as a dedicated Social Security tax (Altman 2005). Proponents of this option hope to restore Social Security to actuarial soundness by using external sources of revenue. The 2001 estate tax provisions allowed an individual to hand down an entire estate to their surviving spouse without paying estate taxes. However, if the spouse chose to leave the estate to another heir, only $675,000 would be exempt from estate tax, and any amount over this would be taxed at 50%. In 2001, the president signed a bill that will lead to the elimination of estate tax in 2010 by gradually increasing the amount exempt from taxation and decreasing the tax rate. The estate tax will then resurface in 2011. One proposal calls for leaving the estate tax frozen at its 2009 level. At this level, $3.5 million per person ($7 million for a husband and wife together) would be exempt from taxation, and any amount over this threshold would be taxable at a rate of 45% (Altman 2005). The taxes collected would no longer be an estate tax but instead a dedicated Social Security tax.

Another approach would be to means test Social Security—determining eligibility for government programs based on income and assets—so that those individuals over a certain income level would receive reduced benefits. Although this approach does not appear in most presentations on reform, recent alterations to the Medicare program indicate that means testing for entitlement programs is certainly on the minds of policy makers. Beginning in 2007, Medicare will use an income test to determine Part B premiums. Those with incomes greater than $80,000 for single beneficiaries and $160,000 for married couples will pay a higher monthly premium based on their income level (Centers for Medicare and Medicaid Services 2006). Means testing alternatives have been presented for Social Security in the past (Ball 1994), but no comprehensive plans of this sort have recently been proposed. Although it appears to be on the back burner, lowering Social Security benefits for high-wage workers is a reform option that may gain momentum in the future.

Several proposals exist that introduce public and private investment strategies as a mechanism for balancing the Social Security system. One public investment strategy calls for the investment of 15% of Social Security Trust Fund assets in equities at an assumed 6.5% inflation-adjusted rate of return, phased in over fifteen years (AARP 2005). The projected figure for this option in Table 1 assumes that future investments perform at a minimum real rate of 6.5%, a number that is historically feasible but not guaranteed. Currently, Social Security is restricted from making investments not guaranteed by the United States government (Altman 2005), leaving the trustees to invest in special issue Treasury bonds rather than publicly traded stocks and bonds. Because this reform option would introduce investing in public securities, concerns exist regarding the appropriateness of the government's role in the investment market (Walker 2005). Thus, this proposal would necessarily include stringent safeguards both to protect the investment's viability and to ensure that market power is not used to influence private companies.

A second investment proposal involves diverting a portion of Social Security benefits to individual retirement accounts. This proposal would seek to increase individual savings through contributions to financial markets (Béland 2005). Although proposals for private investment vary, most are voluntary and involve investing a portion rather than the entire amount paid into Social Security. However, because the proposals suggest changes in the underlying values and structure of Social Security, they are controversial. Private accounts would change the nature of the Social Security system, converting a portion of the program from a defined benefit plan, in which benefits are guaranteed for life, to a defined contribution plan, where the amount of income is finite and based on how much is contributed to the fund over the years as well as how the investments perform. In moving from defined benefit to defined contribution, the responsibility for retirement income would shift from the federal government to the individual retiree. Additionally, the transition costs of privatizing Social Security would introduce a grim forecast of increased government debt (Aaron and Orszag 2004). Marmor and Mashaw (2002) noted that the stakes in considering privatization as an option for reform are high because "crucial values of social solidarity, political stability, and economic fairness are at stake" (185). Moreover, privatization reform options have not sufficiently addressed the disability benefit, which provides a safety net for workers so that if they should become disabled, they along with their spouse and children would not be destitute. Of the nearly forty-eight million individuals in December 2004 receiving Social Security benefits, over one-third (17.7 million, 37%) were spouses and children of retired workers, disabled workers and their dependents, and survivors of deceased workers (Social Security Administration 2005a).

Private investment proponents argue that Social Security is outdated, inequitable, and has not kept up with the progress of women. Abdnor (2004) indicated that although there have been dramatic changes in women's roles in society and the economy, the Social Security benefit structure is basically the same as it was in 1935. Those suggesting more substantive reform note that the current Social Security system provides a substantial subsidy to single-earner marriages, such as couples in which the husband works full time and the wife stays at home. In this situation, the wife may or may not have had children, and the family receives a subsidy regardless of its financial wealth. Married retirees are entitled to the greater of their own benefit or one-half of their spouse's benefit. Thus, women whose Social Security contributions do not entitle them to more than half of their husband's benefits will not receive Social Security based on their own contributions. Rather, these women will receive the same amount as spouses who have not contributed to Social Security. Proponents of privatization suggest that individual accounts offer solutions to this practice by addressing the inequities related to divorce, dual-earner families, and widows' benefits. However, the changing role of women in society means that the proportion of single-earner marriages is decreasing, with a majority of women doing paid work during their lifetime (Herd 2005). Additionally, women earn less per year and live longer after retiring than men (Anrig and Wasow 2005), factors that are compensated for under the current system. Privatization would protect against subsidizing the minority of women who live in single-earner marriages to the detriment of low-income women who must temporarily leave the workforce due to caregiving obligations.

Chile has implemented a model of privatized state pensions. In 1980, the country made a radical move by converting its pay-as-you-go pension system into individual accounts, attempting to correct a retirement system that was in a state of crisis due to unfair practices and an unsound financial structure (Soto 2005). Although trends are improving, Soto indicated that large commissions and administration fees have reduced the funds available to retirees, which is of most consequence to low-wage earners. Between 1981 and 2004, fixed commission fees negatively affected rates of return among the low-income insured (Arenas de Mesa and Mesa-Lago 2006). It appears that the new individual account system has proven to be most beneficial for high-wage earners. Low-wage earners may find themselves relying on means-tested welfare when account accumulations are so low that sole reliance on these funds would leave them living in poverty. In 2005, 11% of participating retirees received the means-tested minimum pension guarantee benefit, a number that Soto (2005) projected will reach 30% as more and more participants find that they have not accumulated sufficient savings to fund a self-sustaining retirement.

A less commonly discussed example of privatization comes from the United Kingdom. The United Kingdom also began its conversion to private pensions in 1980. According to Williamson (2002), this system has brought about some benefit to the overall economy, but this has been minor. However, some negative shifts have accompanied the privatization of the U.K. pension system, including increases in income and gender inequality as well as an increase in poverty rates among older adults. Safeguards against these potential consequences will be crucial if privatization resurfaces as an option for the United States.

Effects on Latino Retirees

In considering the effect of Social Security reform, the evaluator's perspective, political philosophy, and values will exert a great impact on the perceived benefit and disadvantage of each option. The ideologies used to evaluate the various reform approaches presented above will emphasize the specific needs of the Latino community as a whole. Most important, any suggested reform should address the projected long-term actuarial imbalance while maintaining the viability of Social Security. The perspective suggested here is that the redistributive function of Social Security must be maintained, with any increase in revenue coming from those who can most afford to contribute. Likewise, those individuals who are unable to work consistently must not be negatively affected, whether their situation stems from disability, immigration, or caregiving responsibilities. Once a retiree has begun to receive benefits, those payments must be protected, with their value maintained against economic fluctuation. Finally, the reform option should contribute toward the elimination of the legacy debt whenever possible. With these perspectives in mind, Table 2 groups

Table 2. Expected Impact of Social Security Reform Options on Latino Retirees as a Whole

Beneficial impact

- Make 90% of earnings subject to payroll tax over 10 years and maintain at that level
- Raise amount of earnings subject to Social Security payroll tax to $120,000 and subject earnings over $120,000 to a 3% surtax
- Cover newly hired state and local government workers
- Invest 15% of the Social Security Trust Funds in equities, phased in over 15 years, at an assumed 6.5% inflation-adjusted rate of return
- Convert residual estate tax to a dedicated Social Security tax

Potentially detrimental impact

- Reduce the annual cost-of-living adjustment (COLA) by 0.5 percentage points
- Calculate the annual cost-of-living adjustment (COLA) using the more accurate Chained CPI-U in place of the current CPI-W
- Increase benefit computation period from 35 to 38 years, phased in over five years
- Accelerate the current increase in full retirement age to 67 and index future retirement age to longevity, up to age 70
- Tax Social Security like private pensions
- Partially privatize Social Security by creating individual investment accounts
- Use means testing to determine Social Security benefits

Sources: Aaron and Orszag 2004; AARP 2005; Alley, Wilber, and Bengtson 2005; Altman 2005; Chaplain and Wade 2005.

the approaches to reform outlined in this report based on their expected effect on Latino retirees.

Options with Expected Beneficial Impacts

Approaches that are most likely to result in a positive impact on Latino retirees as a whole are those that increase the amount paid into Social Security by high-wage workers, those that increase the number of workers contributing to Social Security, and those that actively increase the Social Security Trust Funds without increasing worker contributions. Of these approaches, both increasing the maximum amount of earnings subject to the payroll tax and converting the estate tax into a dedicated Social Security tax would improve the system's viability using the resources of those with high earnings or considerable wealth, preserving Social Security's progressive nature without resulting in a negative impact on low-wage workers. Since the Latino middle and upper classes are relatively small when compared to those of non-Latino whites, these options would affect a relatively small percentage of Latino beneficiaries.

Three of the proposals outlined in Table 2 as beneficial for Latinos have the added benefit of potentially reducing Social Security's legacy debt: creating a 3% surtax above the maximum taxable earnings base, investing 15% of the Trust Funds in equities, and converting the residual estate tax into a Social Security tax. The legacy debt, which has accumulated since the inception of the program, is approximately $11.5 trillion and will need to be financed by those currently younger than fifty-five years of age (Diamond and Orszag 2004). The Latino population will play a significant role in reducing the legacy debt and will contribute heavily to the funds available for Social Security benefits for all current retirees as well as for the baby boom cohort, which is due to retire over the next twenty-five years. The overall Latino population is relatively young, with a median age of twenty-six in 1997, compared to thirty-five for the nation as a whole (Mutchler and Angel 2000). U.S. Census data from 2000 (Ramirez 2004) show that the proportion of working-age Latinos not of the baby boom cohort (between the ages of eighteen and thirty-five) is much larger than that of the nation as a whole. More recent Census data suggest that 90% of the Latino population is currently younger than fifty-five and thus may be called on to help finance the legacy debt. This proportion far outweighs the 76% of non-Latinos who fall into the same age group (U.S. Census Bureau, 2005, Table 1.1). The comparatively large part that Latinos, and potentially all recent immigrant groups, will play in financing the Social Security system in years to come must be considered when weighing the options for reform.

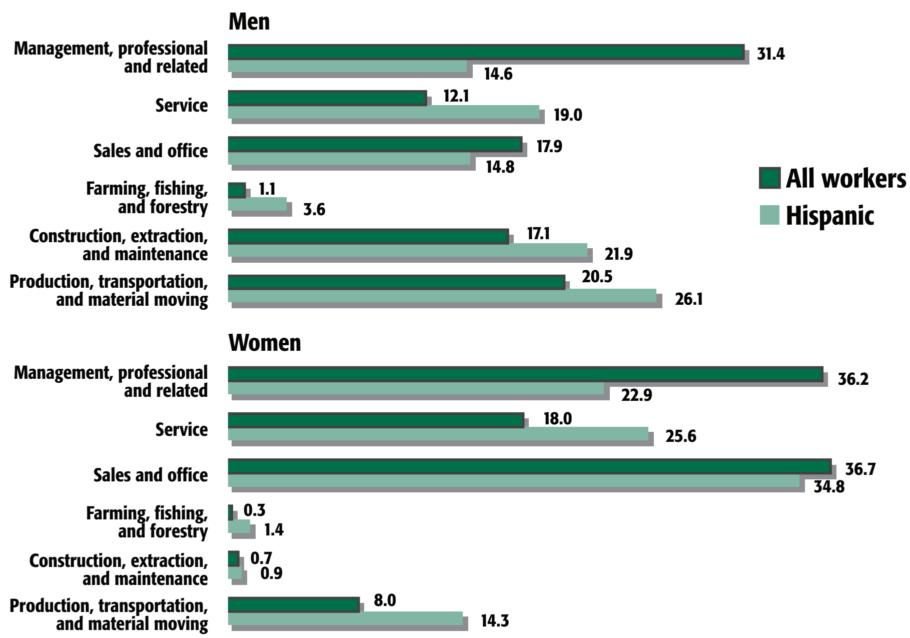
Options with Potentially Detrimental Impacts

Those options that could have the most negative effects on Latinos are modifying annual COLAs, increasing the full retirement age, and extending years of earnings history. In terms of changing the basis of the COLA, any reduction in benefits could have a negative impact on Latino retirees, many of whom are already vulnerable to poverty in retirement. The COLA feature serves retirees very well since it maintains their purchasing power no matter how long they live. This feature is especially important to Latinos, since at age sixty-five they have a longer average life expectancy than the population as a whole (Hendley and Bilimoria 1999).

Based on U.S. Census Bureau occupation data, more than half of Latino men work in jobs that are likely to be physically demanding and in which it is more difficult and less desirable to continue working past the minimum age of retirement (Ramirez 2004). Increasing the retirement age would not only mean more years required in the workforce, but could result in a greater reduction in benefits due to retiring early, at age sixty-two. As Walker (2005) noted, workers in physically demanding occupations (e.g., construction) may be unable to have extended work lives because of the wear and tear of such jobs on physical functioning. U.S. Census data in Figure 1 show that Latinos have higher percentages of participation in labor-intensive jobs such as farming, construction, and production than all other workers in the nation (Ramirez 2004). Reduced Social Security benefits due to early retirement could be the consequence for Latino elders if the full retirement age continues to increase.

Increasing the benefit computation period from thirty-five to thirty-eight years could also disadvantage Latino elders. Overall, groups with short or intermittent work histories, including those who entered the workforce at a later age and women who exited the workforce to care for children or parents, will see the largest reductions in Social Security benefits if this reform option is implemented (Walker 2005). Increasing the number of years used in benefit calculations would further disadvantage those with gaps in their work history. Hendley and Bilimoria (1999) showed that minorities have the highest number of years with no earnings and suggested that this may be due, in part, to immigrants who have not lived in the United States long enough to complete thirty-five years of

FIGURE 1. Occupation of Latinos by Sex, 2000



Source: U.S. Census Bureau data from Ramirez 2004.

Note: Percent distributions based on a sample of the employed civilian population 16 and older. For information on confidentiality protection, sampling error, nonsampling error, and definitions, see http://www.census.gov/prod/cen2000/doc/sf4.pdf.

work. Since the SSA includes periods of no earnings when computing Social Security benefits, these immigrants will receive a lower monthly income in retirement. This forecast is crucial for Latinos, as over 60% of Latinos aged sixty years and older are immigrants (Valdez and Arce 2000). Additionally, Fagnoni (1999) noted that increasing the benefit computation period would have a negative effect on many Latinos because they tend to have lower incomes and a higher risk of poverty.

Taxing Social Security benefits in the same way that private pensions are taxed would impose additional financial burdens on Latinos and low-income workers. While changing the taxation formula in this manner would increase revenue to the Social Security system, these revenues would come disproportionately from the benefits received by retirees who had low earnings over their work history, all other factors being equal. The amount of benefits that is subject to income tax would be determined by subtracting a proportion of the worker's contributions, prorated based on expected lifespan. Low-income workers will have fewer contributions to be subtracted when computing taxable benefits; therefore, high-income workers will pay taxes on a lower percentage of benefits than low-income workers. Additionally, Latinos, who have longer life expectancies than the general population, will be more likely to survive past the time when their contributions have been depleted for tax exemption purposes. Changing the taxation of Social Security benefits to mirror the system in place for private pensions would add a progressive taxation structure to the detriment of long-lived, low-income Latinos.

Alley, Wilber, and Bengtson (2005) noted that Social Security accounts for less than a fifth of the income for the top 20% of retirees. Thus, adding means testing to the benefit structure would result in a relatively small decrease to high-income retirees and a comparatively large increase in benefits for low-income retirees. However, means testing may reduce overall support for the program for two reasons. First, high-wage earners who pay in for all of their working lives will not receive commensurate benefits in return. Second, this method may stigmatize Social Security as a welfare program rather than a social insurance program. The viability of the Social Security system may be put at risk with the addition of means testing due to an elimination of several of its fundamental, guiding principles (Ball 1998).

The proposal to privatize a portion of Social Security is problematic for many Latinos for several reasons. Most important, the transition costs of privatization cast a specter of doubt over the benefit of such a reform. Under a system of individual accounts, the redistributive feature would be more vulnerable to elimination, because what one deposits into a private account plus earnings is what is available upon retirement. Unlike the current approach, privatization proposals have not offered a satisfactory mechanism to redistribute funds to low-wage earners. Implementing the switch to private accounts could leave disadvantaged Latino retirees, who are already twice as likely to be poor as the general population of elders aged sixty-five and older, at risk of economic crisis (Beedon and Wu 2004).

Fagnoni (1999) offered an additional insight when considering the reform option of privatization: "Because blacks and Hispanics on average have lower incomes and are less well educated than whites, the creation of mandatory individual accounts could also decrease their benefits relative to those of whites if they invested more conservatively"

(6-7). She advised that if individual accounts were mandatory, providing information and education would be essential for low-income individuals, including many Latino retirees.

Discussion

Reform options that maintain the progressive benefit structure as well as the COLA feature are crucial to the economic well-being of many Latino elders. Eliminating the progressive benefit structure could have severe economic consequences for those Latino retirees who rely solely on Social Security for their retirement income, further widening the divide in this country between the haves and the have-nots. As demonstrated by over twenty-five years of privatization in Chile, low-wage earners do not fare as well as high-wage earners under a privatized pension system. Although the United States is among the richest countries in the world, there is a great and growing gap between the rich and the poor. Contributing to this gap is the increase in corporate CEO compensation, which grew from over forty times the median income in 1978 to five hundred times the median income in 2000. The number of billionaires in the United States skyrocketed from 1 in 1978 to 120 in 1994; since then, that number has almost tripled to 313 (Geyman 2006). A small percentage of U.S. citizens enjoy the country's greatest wealth. Moreover, the richest 1% of households owns one-third of all the wealth held around the time of retirement (Gokhale 2001). For Latinos, this gap is even larger. The middle class is relatively small when compared to that of non-Latino whites, and the upper class, or wealthiest 25% of Latino households, owns over 90% of Latinos' total wealth (Kochhar 2004). Any proposal for reform must take into account the great diversity of the U.S. population and ensure that any negative impact will not fall disproportionately on those citizens who are least able to bear the burden.

In addition to reform options, there also exists the possibility of simply "shoring up" Social Security by introducing and strengthening other programs. Depending on the political climate, one suggestion that may be further developed in coming years calls for the creation of government-subsidized personal retirement accounts. Unlike the privatization proposals discussed above, these accounts would exist in addition to Social Security and would likely introduce some sort of means testing, funded from the general budget. Such accounts would help low- and moderate-income citizens increase their retirement savings. Other suggestions call for the promotion of private saving and investing through tax incentives. These proposals suggest ways in which the debate over income security and retirement may be broadened to prepare for an increasingly diverse aging population.

Key features vital for economic stability of Latino retirees, who on the whole are vulnerable to poverty in retirement years, include the COLA and the progressive benefit structure vital to the Latino retiree population. This report presents for consideration reform options that do not erode the social insurance aspects of Social Security. While some may believe that the privatization debate is passé and that there is no threat to the current social insurance aspects of Social Security, the concept and premise of privatization has already arrived in the arena of age-based entitlement programs. Whichever options the government ultimately chooses to address anticipated shortfalls in Social Security, those decisions will have implications for Latinos of all ages, both positive and negative.

Perhaps the key factor to consider when evaluating Social Security reform is not the impact of different options on reducing the projected deficit but the role of each option in sustaining the system. While balancing the system is inherently crucial to its successful performance in the future, a series of reforms that secures Social Security's forecast by changing its function and purpose would not necessarily be positive. Ball (1998) outlined nine guiding principles of Social Security, which largely mirror the ideologies presented above. These principles ensure the structural stability of one of this country's most cherished social programs. When analyzing the various options for reform placed before them, policy makers must consider the social contract that has been made with American workers. This report advocates the reform options that maintain Social Security as a redistributive defined-benefit program that can be relied on by Latinos and all workers.

Notes

1. The term *Latino* is used throughout this report. The U.S. Census Bureau uses *Hispanic* for this ethnic population, but considers the two terms synonymous. See http://ask.census.gov. Last accessed May 23, 2007.

2. Social Security beneficiaries can select early retirement at age sixty-two with reduced benefits. However, the age for full retirement benefits, which had been sixty-five since the inception of Social Security, is gradually increasing to sixty-seven. As part of reforms enacted in 1983, this change began in 2000 for those born in 1938 and will end in 2022 for those born in 1960 or later (Social Security Administration 2006).

3. Different assumptions about the long-term future of Social Security result in somewhat different projections; also, although actuarial

estimates are invariably helpful, they are often altered significantly in response to unanticipated economic and demographic performance. Congressional Budget Office figures from June 2006 indicate that payments to beneficiaries will exceed available resources in 2046 (Congressional Budget Office 2006); conversely, the Social Security Board of Trustees estimated in 1997 that the Trust Funds would be exhausted by 2029 (Social Security Administration 1997).

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LATINOS & SOCIAL SECURITY

RESEARCH REPORT

NO. 2

JUNE 2007

SOCIAL SECURITY REFORM

Social Security has substantially improved the economic well-being of millions of Americans, and Latinos are particularly reliant on the program. Unfortunately, the impending retirement of the baby boom generation threatens the long-term viability of Social Security and may weaken the protection that the program offers to elderly Latinos. A number of proposals for reform are currently being debated. This report describes and analyzes these proposals and examines the impact that they will have on Latino retirees as a whole.

MISSION STATEMENT

Latinos and Social Security is an ongoing project to study the impact of Social Security on the Latino population. It is a collaborative research project of the UCLA Center for Policy Research on Aging, the USC Ethel Percy Andrus Gerontology Center, and the UCLA Chicano Studies Research Center, in partnership with the National Hispanic Council on Aging and the National Association of Latino Elected and Appointed Officials (NALEO). Major support is provided by the Ford Foundation.

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Editor: Chon A. Noriega
Senior Editor: Rebecca Frazier
Production: William Morosi

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