Issue Brief

Social Security:
Investment in Family Protection

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Preface

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When Social Security was passed into law in 1935, it was not intended to be an investment program to which Americans could contribute. Rather, it was established as a risk pool to which all Americans were mandated to contribute in order to insure the presence of a stable safety net. Social Security began in the Great Depression but by 1956 it had evolved into a full-scale family-oriented insurance program that included survivors' benefits. Its intent is to provide families with support for the contingencies that occur throughout the course of life, including disability, retirement and survival of widows and children. Thus, dependent spouses and children of victims of the tragic September 11th terrorist attacks will receive Social Security survivors' benefits.

It is amazing to realize that public insurance provided by Social Security to cover disability and death is greater than all private coverage of life and disability, and that it covers some 3 million children as well as older people.

In fulfilling its mission, the International Longevity Center studies a variety of systems to meet the needs of people through their life course in the United States and abroad. This Brief explores the Social Security Program in the US.

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by Robert J. Myers

Social Security is founded upon both social and individual equity principles. Critics who would privatize this vital social insurance program fail to understand its true nature. Their proposal to privatize Social Security, whether partially or completely, would destroy the program's ability to accomplish its purpose.

What would privatization entail? It would mean the voluntary—or mandatory—establishment of individual accounts, which would be financed by a reduction in the Social Security contribution rates and, accordingly, a reduction in Social Security benefits. Advocates of privatization claim that this approach would result in larger total benefits. Individual accounts invested in the stock market, they say, would yield higher rates of investment returns. And so it would for some participants—but not for others.

At issue here is the vast scale of social protection provided by Social Security, which includes old age, survivor, and disability insurance. In 1997, Social Security survivors' benefits amounted to $14.5 trillion.[1] This figure represents the value of all survivors' benefits potentially payable, based on deaths that could occur in 1997. In contrast, the amount of life insurance coverage provided by all private insurance companies then was $13.5 trillion.[2]

Likewise, Social Security disability benefits greatly surpass the disability protection provided by private insurance companies. Although comparable figures are not available, the total value of the protection provided by Social Security disability benefits appears to exceed, by an even greater margin, the total value of disability benefits provided by private insurance companies.

In accordance with the vast scale of this social insurance program, its key objective is social protection—rather than investment return. This issue lies at the heart of the controversy over privatization, and requires closer examination.

Advocates of privatization insist that, for presently active workers, the rate of return on combined employer-employee contributions is only about 2 percent. They fail to acknowledge that those who retired in the past had much higher rates of return—ranging into the double digits. The reason is that retirees in the past had benefit amounts which were not much smaller, payable for almost as long periods, but had contributions at a much lower rate, payable for shorter periods on the average.

This is not an inequity between generations, but rather a social element. Looking at the situation more broadly, as somewhat of an offset in some cases, people who are now retired often supported their parents in their retirement out of their own pockets, whereas this is rarely the case for today's workers.

In other words, the advocates of privatization err by criticizing the Social Security program for not doing what it was not intended to do. Social

Security exists, not to produce investment results, but to produce the insurance results that it actually does provide.

As for the true rate of investment return on contributions under the Social Security program, this figure should be calculated on the basis of employee contributions alone. This approach reveals that, in fact, it is at least the going long-term interest rate earned by the investments of the Social Security trust funds as of the time they are issued—currently about 6 percent.

The key point here is that employer contributions are pooled in order to finance retirement, disability, and survivors benefits for high-cost groups, such as lower-paid workers, and the closed group of all workers who were near retirement age when the program was initiated. Although these workers require insurance protection, they are unable to make the average employee's contribution into the trust fund. Here again, the social nature of the Social Security program is revealed.

Social Security must be preserved as a social investment trust that protects the entire working population. The program does not, in fact, face financing problems in the short run. Problems that may arise in the long run can be solved by a bearable package of small, defined changes in the existing structure of the program. There is no justification for abrogating the principles upon which the Social Security program was founded.

Robert J. Myers is Fellow, Society of Actuaries and Member, American Academy of Actuaries. He was Chief Actuary, Social Security Administration, 1947-70; Deputy Commissioner of Social Security, 1981-82 and Executive Director, National Commission on Social Security Reform (Greenspan Commission), 1982-83. Mr. Myers is a member of the Program Advisory Group, International Longevity Center-USA.

1 Source: Office of the Chief Actuary, Social Security Administration

2 These two figures are not entirely comparable, because private insurance is mostly permanent and term insurance on a level basis, while Social Security survivors' benefits are mostly term insurance on a decreasing basis, although with automatic cost-of-living increases. However, they are indicative of the magnitude of the Social Security program.

The International Longevity Center–USA (ILC–USA) is a not-for-profit, non-partisan research, education and policy organization whose mission is to help individuals and societies address longevity and population aging in positive and productive ways, and highlight older people's productivity and contributions to their families and society as a whole.

The organization is part of a multinational research and education consortium, which includes centers in the U.S., Japan, Great Britain, France and the Dominican Republic. These centers work both autonomously and collaboratively to study how greater life expectancy and increased proportions of older people impact nations around the world.