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# SOCIAL SECURITY REFORM: RISKS, RETURNS, AND RACE

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## INTRODUCTION

Social security is the largest single federal social program. It covers almost all American workers, and provides benefits for retired or disabled workers as well as their dependents and survivors.<sup>1</sup> Today, most retired workers depend on social security benefits as their principal source of income.<sup>2</sup> One of the program's most important achievements has been a dramatic reduction in the poverty rate among elderly Americans.<sup>3</sup> Social security has special importance for blacks and other minority groups who are over-represented among low-wage workers. Social security benefits not only make up a larger share of income for elderly black households than for white households,<sup>4</sup> but also help to mitigate persistent and pronounced racial disparities in household resources.<sup>5</sup>

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<sup>1</sup> In 1996, an estimated 96 percent of all workers in the United States were covered under social security, and most of the remaining 4 percent were state or local government employees who were covered by a public retirement system. See STAFF OF HOUSE COMM. ON WAYS AND MEANS, 105TH CONG., 1998 GREEN BOOK: BACKGROUND MATERIAL AND DATA ON PROGRAMS WITHIN THE JURISDICTION OF THE COMMITTEE ON WAYS AND MEANS 6-10 (Comm. Print 1998) [hereinafter GREEN BOOK]. At the inception of social security in 1935, only workers in commerce and industry—then around 60 percent of the workforce—were covered. See *id.* at 6. For a discussion of the racially skewed impact of the early occupational exemptions (e.g., agricultural and domestic workers) and earnings thresholds, see MELVIN L. OLIVER & THOMAS M. SHAPIRO, BLACK WEALTH/WHITE WEALTH: A NEW PERSPECTIVE ON RACIAL INEQUALITY 38 (1995) (noting that, in 1935, 42 percent of black workers in covered occupations did not earn enough to qualify for benefits, compared to 22 percent of white workers in covered occupations).

<sup>2</sup> See U.S. SOC. SEC. ADMIN., INCOME OF THE POPULATION 55 OR OLDER, 1996 93 tbl.VI.A.1 (1998) [hereinafter INCOME OF THE POPULATION 55 OR OLDER] (in 1996, 61 percent of all units age 65 or older had social security as more than 50 percent of income).

<sup>3</sup> Nevertheless, among elderly social security recipients, the poverty rate for blacks remains more than twice as high as the average rate. See *id.* at 133 tbl.VIII.5 (in 1996, social security reduced the poverty rate from 52 percent to 11 percent among all recipients age 65 or older, and from 62 percent to 26 percent among black recipients age 65 or older).

<sup>4</sup> See *id.* at 111 tbl.VI.B.4 (in 1996, social security represented more than 50 percent of household income for 75 percent of black social security recipients age 65 or older, compared to 65 percent of white social security recipients age 65 or older).

<sup>5</sup> See *infra* notes 114 & 115 and accompanying text.

Although social security enjoys widespread popular support, the viability of the existing system is increasingly being called into question. As baby boomers begin to retire, the ratio of current workers to retired workers will decline sharply, triggering a corresponding decrease in the ratio of annual revenue collections to annual benefit payments. According to recent projections, the system will be able to pay only around 71 percent of promised benefits after 2034.<sup>6</sup> While some changes in the existing system appear inevitable, the nature and direction of future reform remain highly controversial. Some reformers seek to preserve social security more or less in its present form with modest adjustments, while others propose to move toward a privatized system.<sup>7</sup> Proponents of privatization argue that replacing all or part of the existing defined-benefit system with a defined-contribution system of private accounts would leave all workers better off in the long-run.<sup>8</sup>

The debate over social security reform has far-reaching implications for the economic well-being of blacks and other minority groups. In this article, we examine how blacks have fared under the existing system, and then consider the likely consequences of moving toward a privatized system.<sup>9</sup> Specifically, we consider the claim, recently advanced by some privatizers, that blacks receive an especially "bad deal" under the existing system and would be better off under a privatized system.<sup>10</sup> We find that, for blacks as a group, this claim tends to overstate both the

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<sup>6</sup> At present, social security generates annual surpluses which are accumulated in the social security trust funds and invested in government bonds. According to recent projections, annual benefit payments will exceed annual payroll tax revenues beginning in 2014, and the trust funds will be exhausted in 2034. Thereafter, annual tax revenues will be sufficient to pay only around 71 percent of annual expenditures. See BOARD OF TRUSTEES OF THE FED. OLD-AGE AND SURVIVORS INS. AND DISABILITY INS. TRUST FUNDS, 1999 ANNUAL REPORT 3-4 (1999).

<sup>7</sup> In general, privatization implies that payroll taxes would be used to fund private accounts for individual workers. Furthermore, individual workers would control the investment of funds in their own accounts. See *infra* notes 55-57 and accompanying text.

<sup>8</sup> See *infra* notes 58-60 and accompanying text.

<sup>9</sup> A richer discussion would examine the implications of privatization for other minority groups as well as blacks. A major difficulty in assessing the impact of social security on different racial or ethnic groups stems from the nature of the available data. Data are frequently broken down by racial or ethnic categories, but those categories tend to shift over time. Thus, for example, a simplistic distinction between "white" and "nonwhite" fails to differentiate blacks from other minority groups such as Hispanics, Asians, and Native Americans. See Dean R. Leimer, *Historical Redistribution Under the Social Security Disability Insurance Program*, 61 SOC. SECURITY BULL. 3, 4 (1998); James E. Duggan et al., *Returns Paid to Early Social Security Cohorts*, 11 CONTEMP. POL'Y ISSUES 1, 5 (1993); *Social Security and Minorities: Current Benefits and Implications of Reform, Testimony before Subcomm. on Social Security of the House Comm. on Ways and Means*, 106th Cong., 1 n.1 (1999) [hereinafter *Social Security and Minorities*] (statement of Cynthia M. Fagnoni).

<sup>10</sup> See WILLIAM W. BEACH & GARETH G. DAVIS, *SOCIAL SECURITY'S RATE OF RETURN* 15 (1998) ("the Social Security system is a bad deal"); cf. OLIVER & SHAPIRO, *supra* note 1, at 39 ("the social security program today is a system in which blacks pay more to receive less").

shortcomings of the existing system and the advantages of privatization. Furthermore, we urge that the racial impact of social security reform deserves serious and sustained consideration. While the path of reform will inevitably require difficult tradeoffs between competing policy goals and political constituencies, no serious reform proposal can ignore the issue of racial equity in the debate over social security.<sup>11</sup>

## I. SOCIAL SECURITY—A “BAD DEAL” FOR BLACKS?

### A. SOCIAL SECURITY AND ITS CRITICS

The existing “pay-as-you-go” system finances social security benefits primarily through flat-rate payroll taxes imposed on the earnings of current workers up to a specified earnings cap.<sup>12</sup> The primary benefit payable to a retired or disabled worker is determined according to a progressive formula, based on the worker’s average covered earnings prior to retirement or disability.<sup>13</sup> Due to the progressive benefit formula, the percentage of the worker’s earnings represented by the primary benefit (known as the “replacement rate”) varies inversely with the level of covered earnings. Thus, while high earners receive higher benefits in absolute terms, low earners receive a higher percentage of their prior earnings. In addition to the primary benefit, social security provides auxiliary benefits for the retired or disabled worker’s spouse and dependents, as well as survivor benefits following the worker’s death.

The progressive tilt in the benefit formula is designed to provide an adequate level of income for low earners, who are least likely to have accumulated private savings during their working years. Similarly, the auxiliary and survivor benefits are intended to provide support for depen-

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<sup>11</sup> See *Social Security: Restoring Long-Term Solvency Will Require Difficult Choices, Testimony Before the Senate Special Comm. on Aging*, 105th Cong. 7 (1998) (statement of Jane L. Ross) (“In addition to examining the effects of reform proposals on all retirees generally, attention should be paid to how they affect specific subpopulations, especially those that are most vulnerable to poverty, including women, widows, minorities, and the very old.”); *House Comm. on Ways and Means, Report of the 1979 Advisory Council on Social Security*, 96th Cong. 137 (1980) [hereinafter *1979 Advisory Council Report*] (“one of the important factors to be considered in making any changes in the social security program is the effect the change will have on racial and ethnic minorities”); Beverly I. Moran & William Whitford, *A Black Critique of the Internal Revenue Code*, 1996 Wis. L. Rev. 751, 802-03 (noting importance and difficulty of accommodating both public policy goals and racial equity).

<sup>12</sup> See 26 U.S.C. §§ 3101(a), 3111(a) (payroll taxes imposed at 12.4 percent rate, split equally between employers and employees); 42 U.S.C. § 430 (earnings cap). For 1998, the earnings cap was \$68,400. See U.S. Soc. Sec. ADMIN., ANNUAL STATISTICAL SUPPLEMENT TO THE SOCIAL SECURITY BULLETIN 37 tbl.2.A3 (1998) [hereinafter 1998 STATISTICAL SUPPLEMENT].

<sup>13</sup> See 42 U.S.C. §§ 402(a), 415, 423(a). For workers becoming eligible in 1998, the basic monthly old-age benefit was equal to 90 percent of the first \$477 of average indexed monthly earnings (AIME), plus 32 percent of the next \$2,398 of AIME, plus 15 percent of AIME over \$2,875. See 1998 STATISTICAL SUPPLEMENT, *supra* note 12, at 48 tbl.2.A11.

dent family members. These redistributive features are grounded in considerations of "social adequacy," which aims to provide adequate protection for all workers against loss of earnings due to retirement or disability.<sup>14</sup> At the same time, the redistributive features of the existing system are in tension with the goal of "individual equity" which suggests that individual workers should receive an actuarially fair return in the form of benefits relative to their contributions.

Social security strikes a delicate balance between these competing goals of social adequacy and individual equity. Social adequacy implies the need for some redistribution, but individual equity views redistribution of any sort as a windfall to some groups at the expense of others. Undoubtedly, the structure of social security as a program of defined benefits with pay-as-you-go financing has facilitated massive net transfers of wealth within and across generations. By contrast, moving toward a defined-contribution system with private accounts for individual workers would represent a decisive shift in the direction of individual equity. Indeed, the standard argument in favor of privatizing social security asserts that the existing system represents a "bad deal" for current and future workers and that a privatized system would provide higher returns while promoting national saving and economic growth in the long run.<sup>15</sup>

Proposals for privatizing social security are usually directed at young workers with high-expected earnings, who stand to reap the most obvious and substantial benefits from a system of private accounts. Nevertheless, some privatizers have attempted to enlist support among blacks and other nontraditional constituencies by focusing on relative rates of return under the existing system. Specifically, a report recently issued by the Heritage Foundation claims that "Social Security offers a worse deal

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<sup>14</sup> Although social security covers almost all American workers, *see supra* note 1, coverage extends only to those regularly employed in the workforce. It would be possible, of course, to design a comprehensive system of universal benefits based solely on need, without regard to contributions, but such a system would represent a fundamental departure from the existing model of social security. *See* Karen C. Burke & Grayson M.P. McCouch, *Women, Fairness, and Social Security*, 82 IOWA L. REV. 1209, 1218-19 (1997); *cf.* Mary E. Becker, *Obscuring the Struggle: Sex Discrimination, Social Security, and Stone, Seidman, Sunstein & Tushnet's Constitutional Law*, 89 COLUM. L. REV. 264, 279-83 (1989) (questioning wage-based structure of social security); OLIVER & SHAPIRO, *supra* note 1, at 38-39 (noting impact of coverage and benefit structure on blacks).

<sup>15</sup> *See* BEACH & DAVIS, *supra* note 10, at 15 ("many ordinary Americans already understand that the Social Security system is a bad deal"); *id.* at 16 ("For almost every type of worker and family, retirement under Social Security means receiving fewer dollars in old age and passing on less wealth to the next generation than they could if allowed to place their current Social Security tax dollars in private retirement accounts."); *see also* Steven Caldwell et al., *Social Security's Treatment of Postwar Americans*, in 13 TAX POLICY AND THE ECONOMY 109, 110 (James M. Poterba ed., 1999) (describing rates of return for postwar cohorts as "quite low"); I REPORT OF THE 1994-1996 ADVISORY COUNCIL ON SOC. SECURITY 102-08 (1997) [hereinafter 1994-1996 ADVISORY COUNCIL REPORT] (statement by Joan T. Bok et al.).

[for a black worker] than it does for a white worker with an identical income and family structure.”<sup>16</sup> This claim, if substantiated, amounts to a charge of racially discriminatory impact in the existing system, and deserves careful scrutiny.

## B. INCOME, RACE, AND MORTALITY

At first glance, the Heritage Foundation’s claim may seem somewhat surprising, since black workers as a group have disproportionately low earnings compared to the general population<sup>17</sup> and therefore might be expected to enjoy a net advantage from the existing system with its progressive benefit formula. However, it is generally recognized that the progressivity of the benefit formula is blunted by a countervailing mortality effect. Low earners have shorter life expectancies than the general population, and receive correspondingly lower returns in the form of old-age and survivor benefits.<sup>18</sup> Furthermore, since blacks have shorter life expectancies than whites, even after mortality rates are adjusted for income, some studies conclude that blacks receive a slightly lower rate of return than whites in the form of old-age and survivor benefits.<sup>19</sup>

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<sup>16</sup> WILLIAM W. BEACH & GARETH G. DAVIS, *SOCIAL SECURITY’S RATE OF RETURN: A REPLY TO OUR CRITICS* 8 (1998); see also BEACH & DAVIS, *supra* note 10, at 8 (comparing rates of return); Caldwell et al., *supra* note 15, at 133 (claiming that nonwhites experience higher lifetime net tax rates than whites due to shorter life expectancy).

<sup>17</sup> See U.S. DEP’T OF COMMERCE, *STATISTICAL ABSTRACT OF THE UNITED STATES* 436 tbl.696 (1998) [hereinafter 1998 *STATISTICAL ABSTRACT*] (in 1997, full-time black workers had median weekly earnings of \$400, compared to \$519 for full-time white workers).

<sup>18</sup> See Julia Lynn Coronado et al., *Distributional Impacts of Proposed Changes to the Social Security System*, in 13 *TAX POLICY AND THE ECONOMY* 149, 170 (James M. Poterba ed., 1999) (finding that income-differentiated mortality reduces progressivity of old-age and survivor benefits by more than 50 percent); Daniel M. Garrett, *The Effects of Differential Mortality Rates on the Progressivity of Social Security*, 33 *J. ECON. INQUIRY* 457, 457 (1995) (suggesting that the mortality effect of being poor may be strong enough to offset the progressivity of old-age benefits); C. EUGENE STEUERLE & JON M. BAKJA, *RETOOLING SOCIAL SECURITY FOR THE 21ST CENTURY: RIGHT AND WRONG APPROACHES TO REFORM* 119 (1994) (concluding that mortality rates and other characteristics related to income level weaken the progressivity of social security but “the impact is not very large”); cf. *Social Security and Minorities*, *supra* note 9, at 3 (statement of Cynthia M. Fagnoni) (“The consensus among researchers is generally that the progressivity of the benefit formula outweighs the negative effect of lower life expectancy for blacks in terms of what they contribute.”); HENRY J. AARON, *ECONOMIC EFFECTS OF SOCIAL SECURITY* 80 (1982) (“On balance, it is clear that such factors as differential mortality and age of entry offset, but do not eliminate, the progressivity of the social security benefit formula, that survivors and disability insurance reinforce it, and that social security has provided relatively larger lifetime wealth increments to cohorts with low earnings and, within those cohorts, to workers with low earnings.”).

<sup>19</sup> See CONSTANTIN W.A. PANIS & LEE A. LILLARD, *SOCIOECONOMIC DIFFERENTIALS IN THE RETURNS TO SOCIAL SECURITY* 20 (RAND Labor and Population Program Working Paper Series 96-05, 1996) (concluding that “whites experience higher returns than blacks at a given income level and marital status,” due to differential mortality rates); see *id.* at 14 (estimating difference as around half a percentage point); Caldwell et al., *supra* note 15, at 112-13 (finding that due to shorter life expectancies, nonwhites face “slightly higher (about a third of a per-

Calculating accurate rates of return on social security contributions is no easy task. Most empirical studies derive flows of contributions and benefits from simulated work histories based on stylized profiles of hypothetical workers differentiated by a limited number of specified characteristics (e.g., race, sex, marital status, and earnings level).<sup>20</sup> Even when performed with the utmost care, this simulation approach inevitably misses other relevant variables (e.g., work history, earnings patterns, divorce, remarriage, and mortality) that may significantly affect rates of return.<sup>21</sup> These problems could be avoided by using real-world data based on actual work histories, but such data are largely unavailable or incomplete. The most comprehensive data set based on actual work histories is the "continuous work history sample" maintained by the Social Security Administration,<sup>22</sup> but because this sample tracks individuals rather than households, studies relying on it must use simulated work histories of unobserved household members.<sup>23</sup>

Although the Heritage Foundation report complains of the Social Security Administration's "stunning silence" about rates of return for minority groups,<sup>24</sup> the report itself illustrates the need for care in interpreting available data and calculating rates of return. Specifically, the

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centage point)" lifetime net tax rates than whites). *But see* Dean R. Leimer, *Lifetime Redistribution Under the Social Security Program: A Literature Synopsis*, 62 Soc. SECURITY BULL. 43, 45 (1999) ("On average, whites appear to have received lower rates of return than nonwhites, due in part to the historically lower earnings of nonwhites coupled with the progressivity of the benefit formula; these factors appear to outweigh the generally lower survival probabilities for nonwhites."); *id.* at 47 n.15 (noting that "[c]onclusions regarding differential treatment by race under the OASI program have been less consistent across studies than conclusions regarding differential treatment across earnings, gender, and marital status groups").

<sup>20</sup> *See, e.g.*, STEUERLE & BAKIJA, *supra* note 18, at 99-102 (specifying assumptions and methods); *cf.* Caldwell et al., *supra* note 15, at 115-16 (pointing out shortcomings of Steuerle/Bakija model); *id.* at 111 (describing simulation model based on representative sample which "ages, marries, divorces, fertilizes, educates, employs, unemploys, re-employs, retires, and kills original sample members and their descendants" and calculates social security taxes and benefits).

<sup>21</sup> *See* Dean R. Leimer, *A Guide to Social Security Money's Worth Issues*, 58 Soc. SECURITY BULL. 3, 8. n.9 (1995). The simulation approach can be refined by using improved data and analysis; with increasingly detailed hypothetical worker profiles, however, it becomes correspondingly more difficult to obtain adequate data sources and perform the necessary analysis. *See id.*; *see also* Leimer, *supra* note 19, at 46-47 n.3.

<sup>22</sup> *See* Creston M. Smith, *The Social Security Administration's Continuous Work History Sample*, 52 Soc. SECURITY BULL. 20 (1989); Duggan et al., *supra* note 9, at 8-9 (analyzing continuous work history sample data for 1951 to 1988 and finding that blacks received "relatively favorable" rates of return compared to the overall sample).

<sup>23</sup> *See* Garrett, *supra* note 18, at 458-60; Coronado, *supra* note 18, at 153 (noting that sample ignores earnings above the social security earnings cap and that records of individuals are not linked with records of spouses).

<sup>24</sup> BEACH & DAVIS, *supra* note 16, at 15; *but see* Leimer, *supra* note 19, at 46 (discussing rates of return for minority groups and concluding that existing studies of both the OASI and DI programs suggest that "within cohorts nonwhites have received more favorable relative treatment than whites, on average").

Heritage Foundation report adopts several questionable assumptions which tend to maximize racial differences in mortality rates. For example, in calculating rates of return, the report assumes a uniform average life expectancy for all black workers and another uniform average life expectancy for all white workers. As a result, the report accentuates the racial disparity in mortality rates while ignoring differences in income levels and other socioeconomic factors.<sup>25</sup> The report also assumes that each hypothetical black or white worker lives exactly as long as the group's average life expectancy. This assumption disregards the probability that the hypothetical worker may die earlier or later than expected, and ignores the concomitant effects on rates of return.<sup>26</sup> Furthermore, the report compares average life expectancies for hypothetical black and white workers at the beginning of their working lives rather than at retirement age. Since life expectancies tend to converge at higher ages, the racial disparity is considerably smaller among workers who actually survive to collect old-age benefits than the report implies.<sup>27</sup> To the

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<sup>25</sup> See BEACH & DAVIS, *supra* note 10, at 21-22 (life expectancy assumptions); KILOLO KIJAKAZI, AFRICAN AMERICANS, HISPANIC AMERICANS, AND SOCIAL SECURITY: THE SHORT-COMINGS OF THE HERITAGE FOUNDATION REPORTS 27-28 (Center on Budget and Policy Priorities, 1998) ("failing to compare mortality rates for whites and minorities with the same income levels. . . exaggerates the impact of race on rates of return"); BEACH & DAVIS, *supra* note 16, at 6 (calculating rate of return using average life expectancies, not adjusted by income level). Recent studies suggest that controlling for variables other than race eliminates most, if not all, of the difference between black and white mortality rates. See Leimer, *supra* note 19, at 45; see also Paul L. Menchik, *Economic Status as a Determinant of Mortality Among Black and White Older Men: Does Poverty Kill?*, 47 *POPULATION STUDIES* 427, 435 (1993) (finding 75 percent of differential black mortality rates attributable to economic and environmental variables); Richard G. Rogers, *Living and Dying in the U.S.A.: Sociodemographic Determinants of Death Among Blacks and Whites*, 29 *DEMOGRAPHY* 287, 297-99 (1992) (attributing differential black mortality rates to demographic, familial, and socioeconomic factors).

<sup>26</sup> Workers who die before retirement receive no old-age benefits, but due to their reduced working years they also contribute less in payroll taxes. Long-lived workers receive old-age benefits for more years although their payroll tax contributions cease at retirement. See KIJAKAZI, *supra* note 25, at 11-13 (pointing out effect of report's methodology on ratio of expected retirement years to expected working years); BEACH & DAVIS, *supra* note 16, at 3-4 (defending use of "average life expectancy" rather than "expected value").

<sup>27</sup> In general, individual life expectancy increases with attained age, and group life expectancies tend to converge. The following table shows life expectancies for black and white women and men of specified ages in 1996:

	WOMEN		MEN	
	Black	White	Black	White
Birth	74.2	79.6	66.1	73.8
Age 20	55.7	60.4	48.0	54.8
Age 40	37.0	41.0	31.0	36.3
Age 50	28.6	31.7	23.4	27.5
Age 65	17.2	19.0	13.9	15.8



extent that the report overstates racial disparities in mortality rates, it distorts the rate-of-return calculations and undermines the Heritage Foundation's claim that "[d]ue to generally lower life expectancies, [blacks] experience particularly poor rates of return from Social Security."<sup>28</sup>

In discussing the issue of mortality rates, the Heritage Foundation report compares social security to an "imaginary lottery" in which one contestant wins a prize and the others lose their stakes.<sup>29</sup> The lottery image highlights the mortality gamble inherent in any retirement-annuity system: workers who die prematurely subsidize increased annuity benefits for those who live the longest. Nevertheless, it would be misleading to view workers who die before retirement as receiving no return at all on their contributions. Despite its many redistributive features, social security is fundamentally a program of insurance against loss of earnings during retirement or disability, and, like any insurance system, it shifts and spreads risk. Workers who die prematurely incur an ex post loss, but they still receive the ex ante benefit of coverage throughout their lives. The real issue is not whether social security involves a mortality gamble—it clearly does—but whether the gamble is fair. If the existing structure of old-age benefits systematically discriminates against blacks or other minority groups, the problem could be rectified by providing mandatory life insurance to neutralize the mortality risk.<sup>30</sup> Presumably, such a life insurance component, like the existing old-age annuity component, would be based on uniform mortality rates without differentiation by race or sex.<sup>31</sup> Furthermore, in assessing the overall impact of the existing system it is necessary to consider several key features that tend to offset the discriminatory effects alleged in the Heritage Foundation report.<sup>32</sup>

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See 1998 STATISTICAL ABSTRACT, *supra* note 17, at 94 tbl.129.

<sup>28</sup> BEACH & DAVIS, *supra* note 10, at 10.

<sup>29</sup> BEACH & DAVIS, *supra* note 16, at 4.

<sup>30</sup> See Peter A. Diamond, *The Economics of Social Security Reform*, in FRAMING THE SOCIAL SECURITY DEBATE: VALUES, POLITICS, AND ECONOMICS 38, 57 (R. Douglas Arnold et al. eds., 1998).

<sup>31</sup> Alternatively, old-age annuity benefits could be adjusted to reflect mortality differences based on race and sex. Such adjustments would increase annuity benefits for shorter-lived groups (i.e., blacks and men, at least those who reached retirement age) while reducing them for longer-lived groups (i.e., whites and women), and might produce some surprising net transfers (e.g., from black women to white men). *But see 1979 Advisory Council Report*, *supra* note 11, at 125 (rejecting "explicit differentiation among racial or ethnic groups" under social security); Kathryn L. Moore, *Partial Privatization of Social Security: Assessing Its Effect on Women, Minorities, and Lower-Income Workers*, 65 Mo. L. Rev. 341, 373-76 (2000) (discussing race- and sex-differentiated mortality tables).

<sup>32</sup> See Alexa A. Hendley & Natasha F. Bilimoria, *Minorities and Social Security: An Analysis of Racial and Ethnic Differences in the Current Program*, 62 Soc. SECURITY BULL. 59, 61-63 (1999) (discussing importance for minorities of progressive benefit formula as well

### C. COUNTERVAILING FEATURES

It is important at the outset to recognize that social security functions as part of a larger tax-and-transfer system. Within that system, the earned income tax credit (EITC)<sup>33</sup> partially offsets the regressivity of flat-rate payroll taxes for low-income workers.<sup>34</sup> The EITC in effect subsidizes the payroll tax liability of eligible workers from general revenues by means of a refundable tax credit.<sup>35</sup> By failing to take the EITC into account, the Heritage Foundation report may overstate the effective rate of payroll taxes for black workers.<sup>36</sup> Similarly, by ignoring other features of the tax-and-transfer system that implicitly reinforce the progressivity of social security,<sup>37</sup> the Heritage Foundation report tends to oversimplify and distort the impact of the existing system.

Another important feature ignored by the Heritage Foundation report is the option of early retirement.<sup>38</sup> Under the existing system, a worker can elect to retire and begin receiving reduced old-age benefits as early as age 62. Indeed, around two-thirds of all workers, including minority workers, do so.<sup>39</sup> The reduction in old-age benefits for workers who retire early reflects the increase in the worker's retirement years relative to working years, and is designed to be nearly neutral in present value terms for workers of average longevity. For blacks and other

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as disability and survivor benefits); 1979 *Advisory Council Report*, *supra* note 11, at 137 (rejecting claim that overall impact of social security is unfair to minorities).

<sup>33</sup> See 26 U.S.C. § 32.

<sup>34</sup> See George K. Yin et al., *Improving the Delivery of Benefits to the Working Poor: Proposals to Reform the Earned Income Tax Credit Program*, 11 AM. J. TAX POL'Y 225, 230 (1994) ("[a]n important goal of the [EITC] program is to offset the Social Security taxes paid by low-income workers"); Anne L. Alstott, *The Earned Income Tax Credit and the Limitations of Tax-Based Welfare Reform*, 108 HARV. L. REV. 533, 534 (1995) (noting traditional view of EITC as "a means of offsetting the adverse distributional and incentive effects of federal income and payroll taxes on low-income workers"). As the EITC has expanded, it has also come to be viewed as providing work incentives and offering a tax-based alternative to traditional public assistance programs; in addition, it is often portrayed as mitigating the regressive effects of other tax proposals. See Yin et al., *supra*, at 230; Alstott, *supra*, at 534.

<sup>35</sup> See Yin et al., *supra* note 34, at 283 n.193 ("the EITC has already decoupled the link between Social Security taxes and benefits").

<sup>36</sup> See KHAKAZI, *supra* note 25, at 14; John Karl Scholz, *The Earned Income Tax Credit: Participation, Compliance, and Antipoverty Effectiveness*, 47 NAT'L TAX J. 63, 86 tbl.1 (1994) (in 1990, 24 percent of EITC-eligible taxpayers were black). Further empirical study is needed to assess the racial impact of the EITC, since a significant percentage of eligible households do not actually participate in the EITC program. See *id.* at 65 (estimated 80 to 86 percent participation rate in 1990).

<sup>37</sup> See 26 U.S.C. § 86 (1999) (targeting income taxation of social security benefits at moderate- and high-income taxpayers).

<sup>38</sup> See BEACH & DAVIS, *supra* note 10, at 17 (assuming worker begins work at age 21 and continues working until entitled to full old-age benefit).

<sup>39</sup> See KHAKAZI, *supra* note 25, at 15 ("about two-thirds of all workers, including minority workers, take early retirement"); GREEN BOOK, *supra* note 1, at 21 tbl.1-12 (in 1995, 58.3 percent of workers elected to receive old-age benefits before age 62, and another 19.5 percent before age 65).

groups with shorter-than-average life expectancies, however, early retirement actually increases the rate of return on social security contributions because the benefit reduction does not fully offset the disproportionate increase in the ratio of retirement years to working years.<sup>40</sup> Thus, the option of early retirement provides a net benefit to black workers as a group.

Another key feature omitted from the Heritage Foundation report involves the benefits payable to disabled workers and their dependents and survivors. Given the strong positive correlation between income and health, it should come as no surprise that a relatively large percentage of recipients of disability and survivor benefits are black.<sup>41</sup> Indeed, the disability component of social security appears to have a pronounced redistributive effect in favor of blacks, which may outweigh any opposite effect attributable to mortality rates.<sup>42</sup> Moreover, there is evidence of a disturbing upward trend in disability rates, especially among black workers relative to white workers.<sup>43</sup> The Heritage Foundation report purports to carve out the disability component as well as the pre-retirement survivor component of social security from its analysis by ignoring both contributions and benefits attributable to those components.<sup>44</sup> Although

<sup>40</sup> See KJAKAZI, *supra* note 25, at 13-15.

<sup>41</sup> In 1997, 10.3 percent of all social security beneficiaries were black, but blacks represented higher percentages of those receiving disability or survivor benefits, as shown in the following table:

	Black	White	Other
Total beneficiaries	10.3	86.3	2.9
Disabled workers	17.8	74.9	6.3
Spouses of disabled workers	14.0	77.3	7.7
Children of disabled workers	22.1	67.8	8.9
Survivors	13.5	82.9	2.9

These percentages are derived from data contained in the 1998 STATISTICAL SUPPLEMENT, *supra* note 12, at 198 tbl.5.A6 (note that because persons of unknown race were not included in the underlying data, the numbers in each row add up to slightly less than 100 percent). See also Hendley & Bilimoria, *supra* note 32, at 62 ("A larger percentage of minority groups . . . receive disability and survivor benefits than do whites.").

<sup>42</sup> See KJAKAZI, *supra* note 25, at 24; Leimer, *supra* note 9, at 9 ("differences in such factors as earnings levels, disability rates, and dependent beneficiary relationships appear to work in favor of Nonwhites relative to Whites under the DI program and also appear to collectively outweigh any opposing effect associated with differences in survival probabilities"); *id.* at 27 (concluding that accumulated benefit/tax ratios suggest that, over time, the disability component has produced "a net redistribution from males to females and a more pronounced redistribution from Whites to Nonwhites"); 1979 *Advisory Council Report*, *supra* note 11, at 125-26 (noting that for minorities the effect of shorter life expectancy is offset by the effect of disability and survivor benefits, as well as progressive benefit formula).

<sup>43</sup> See Leimer, *supra* note 9, at 11.

<sup>44</sup> See BEACH & DAVIS, *supra* note 16, at 8-9 (defending report's approach); *cf.* KJAKAZI, *supra* note 25, at 23-25 (criticizing report's method of calculating the portion of contributions allocable to the pre-retirement survivor component).

many other studies also exclude the disability component in calculating rates of return on social security, it is important to note that disability benefits represent one of the most favorable features of social security for blacks as a group.<sup>45</sup>

Finally, social security extends benefits to a worker's spouse and eligible dependents, both during retirement or disability and after the worker's death.<sup>46</sup> These auxiliary and survivor benefits represent a marked departure from individual equity because they supplement the primary worker benefit at no additional cost to the worker or the recipients. Thus, these benefits substantially enhance the rates of return on contributions for some households at the expense of others, based solely on marital status and family relationships.

When auxiliary and survivor benefits were first introduced, they were justified on grounds of social adequacy as a means of meeting the presumably greater needs of workers with dependent family members. Over time, however, the rationale and impact of these benefits have become increasingly controversial.<sup>47</sup> For example, the spousal benefit provisions redistribute from unmarried individuals to married couples and from two-earner couples to one-earner couples.<sup>48</sup> These provisions have attracted criticism on the ground that they encourage married women to stay at home rather than enter the paid workforce.<sup>49</sup> More generally, since the auxiliary and survivor benefit provisions favor "traditional" households,<sup>50</sup> they may be viewed as imposing an indirect penalty on households with different family structures and earnings patterns.

Spousal benefits are concentrated among married couples in which one spouse earns all (or nearly all) of the wages; the spousal benefit declines or disappears as the couple's combined wages are split more

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<sup>45</sup> See KJAKAZI, *supra* note 25, at 21 ("African-Americans benefit disproportionately from the disability and survivors components of Social Security. By removing these parts of Social Security from its calculations, Heritage disregards the elements of Social Security most favorable to them.")

<sup>46</sup> See GREEN BOOK, *supra* note 1, at 15-16 (describing auxiliary and survivor benefits).

<sup>47</sup> See Burke & McCouch, *supra* note 14, at 1225-32, and sources cited therein.

<sup>48</sup> Under the "dual entitlement" provisions, the total benefit payable to a worker's spouse is limited to the greater of (1) the spouse's auxiliary benefit or (2) the primary benefit attributable to the spouse's own earnings, if any. See 42 U.S.C. § 402(k)(3)(A). Thus, a working spouse may be viewed as receiving no marginal return on contributions until the primary benefit exceeds the auxiliary benefit.

<sup>49</sup> See Edward J. McCaffery, *Taxation and the Family: A Fresh Look at Behavioral Gender Biases in the Code*, 40 UCLA L. REV. 983, 987-88, 996-1005 (1993); see also Becker, *supra* note 14, at 279-83.

<sup>50</sup> See McCaffery, *supra* note 49, at 999 (arguing that social security reinforces bias in favor of "traditional" families with a "working husband" and a "stay-at-home wife"); Becker, *supra* note 14, at 283 (arguing that social security systematically favors "those who have successfully fulfilled men's traditional breadwinner role over those who fulfilled women's traditional roles").

equally between the respective spouses. Recent studies indicate that at all income levels black couples are more likely than white couples to earn equal (or nearly equal) wages,<sup>51</sup> and that black women are less likely than white women to collect spousal benefits.<sup>52</sup> These studies suggest that the distribution of spousal benefits may be racially skewed.<sup>53</sup> Nevertheless, the distribution of social security benefits is influenced by so many variables—marriage, divorce, number of children, work history, earnings level, health, and mortality, to name a few—that any conclusion about the rate of return on contributions for black households remains highly speculative.<sup>54</sup> The racial impact of social security is undoubtedly far more subtle and complex than portrayed in the Heritage Foundation report.

## II. PRIVATIZATION—A BETTER DEAL?

In addition to the claim that social security represents an especially bad deal for blacks, the Heritage Foundation report argues that blacks would fare better under a fully privatized system. Even if the first claim remains unproven, the proposal to move toward a privatized system deserves close attention. While privatization has taken center stage in the debate over social security reform, the implications for blacks and other minority groups have only recently begun to be explored.

### A. GOALS OF A FULLY PRIVATIZED SYSTEM

Full privatization, as contemplated by the Heritage Foundation report, implies the conversion of social security from the existing defined-benefit system to a defined-contribution system with private accounts

<sup>51</sup> See Dorothy A. Brown, *Race, Class, and Gender Essentialism in Tax Literature: The Joint Return*, 54 WASH. & LEE L. REV. 1469, 1504-05 tbls.3.5, 3.6 (1997); see also Howard M. Iams, *Earnings of Couples: A Cohort Analysis*, 56 SOC. SECURITY. BULL. 22, 29 (1993) (finding that, among married women born in the 1940's and 1950's, blacks were significantly less likely than others to have low earnings relative to their husbands).

<sup>52</sup> See Kathryn L. Moore, *Redistribution Under the Current Social Security System*, 61 U. PITT. L. REV. (forthcoming 2000) (manuscript at 35-36, on file with authors); 1998 STATISTICAL SUPPLEMENT, *supra* note 12, at 184 tbl.5.A1. By contrast, the same study found that black women and white women are equally likely to receive auxiliary benefits as surviving spouses. See Moore, *supra*, at 36-37; 1998 STATISTICAL SUPPLEMENT, *supra* note 12, at 184 tbl.5.A1.

<sup>53</sup> Cf. Garrett, *supra* note 18, at 460 (noting that if poor households have higher second-earner participation rates compared to the general population, their return will be lower).

<sup>54</sup> See Brown, *supra* note 51, at 1490 n.136 (noting that marriage rate is lower among black women than white women); Moore, *supra* note 52, at 33, 113 & 114 (noting differences between black and white women in marriage and divorce rates); Regina Austin, *Nest Eggs and Stormy Weather: Law, Culture, and Black Women's Lack of Wealth*, 65 U. CIN. L. REV. 767, 769-70 (1997) (comparing wealth and family structure by race).

similar to 401(k) plans or IRAs.<sup>55</sup> Thus, instead of levying payroll taxes on the wages of current workers to pay specified benefits to retired workers and their families, a privatized system would use payroll taxes to fund private accounts for individual workers.<sup>56</sup> Each worker would have control over the investment of his or her account and would be entitled to withdraw the accumulated account balance upon retirement.<sup>57</sup>

According to the Heritage report, a privatized system would yield higher rates of return for current and future workers (and especially for black workers) on their contributions for several reasons. First, a defined-contribution system would eliminate the mortality gamble inherent in the existing defined-benefit system: shorter-lived workers would no longer subsidize longer-lived workers, and benefits would be linked much more closely to contributions. Second, workers would have access to private capital markets, which have historically yielded relatively high returns compared to the existing system.<sup>58</sup> Finally, private accounts would allegedly promote increased national savings and capital formation for the benefit of future generations.<sup>59</sup> In effect, the Heritage Foundation report claims that a rising tide of privatization would lift all boats.<sup>60</sup> The claimed benefits of privatization, like the claimed unfairness of the existing system, deserve closer scrutiny.

## B. MAINTAINING SOCIAL ADEQUACY

Any move in the direction of privatization raises a fundamental concern about maintaining social adequacy. This is due in part to the difference between a system of defined benefits and one of defined

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<sup>55</sup> See BEACH & DAVIS, *supra* note 10, at 2 (“safe investment accounts similar to 401(k) plans”).

<sup>56</sup> For this purpose, payroll taxes include both the employer’s and the employee’s share. See BEACH & DAVIS, *supra* note 10, at 17. However, not all payroll taxes would be diverted to private accounts; a portion would continue to fund the disability and pre-retirement survivor components of the existing system. See *id.* at 17, 20-21 (defending report’s approach); *cf.* KUJAKAZI, *supra* note 25, at 22-25 (criticizing report’s assumptions and methodology).

<sup>57</sup> The features of advance funding, investment diversification, and private accounts are analytically distinct. In theory, any one of them could be implemented without the others. Nevertheless, most privatization proposals include all three features. See John Geanakoplos et al., *Would a Privatized Social Security System Really Pay a Higher Rate of Return?*, in FRAMING THE SOCIAL SECURITY DEBATE, *supra* note 30, at 137, 138-41; Karen C. Burke & Grayson M.P. McCouch, *Perspectives on Social Security Reform*, 4 FLA. TAX REV. 417, 418 (1999).

<sup>58</sup> See BEACH & DAVIS, *supra* note 10, at 10-14 (comparing rates of return on social security and alternative private investments).

<sup>59</sup> See BEACH & DAVIS, *supra* note 10, at 5-6 (arguing that social security “crowds out” private savings for low- and middle-income workers and impedes capital formation); *id.* at 15 (arguing that a privatized system would encourage capital formation and economic growth).

<sup>60</sup> See *id.* at 16 (“For almost every type of worker and family, retirement under Social Security means receiving fewer dollars in old age and passing on less wealth to the next generation than they could if allowed to place their current Social Security tax dollars in private retirement investments.”).

contributions: the former tends to facilitate risk-pooling and redistribution, while the latter tends to emphasize individual equity.<sup>61</sup> To preserve a retirement safety net for low earners, some proposals would privatize only a portion of social security while retaining a defined-benefit component to provide higher benefits for low-income participants through either a progressively-scaled benefit or a flat minimum benefit.<sup>62</sup> By making the redistributive function of the defined-benefit component more isolated and visible, partial privatization might merely lead to increased political pressure for full privatization from middle- and high-income participants.<sup>63</sup> Of course, even in a fully privatized system, it would be technically (though perhaps not politically) possible to preserve an element of progressivity by adjusting credited contributions upward for participants with low incomes and downward for those with high incomes.<sup>64</sup>

The Heritage Foundation report, however, contemplates dismantling the existing system of old-age and survivor insurance and replacing it as soon as possible with a fully privatized system purged of all traces of progressivity.<sup>65</sup> In its enthusiasm for maximizing individual equity, the Heritage report gives no weight at all to considerations of social adequacy. Apparently, workers facing retirement with inadequate assets due to low earnings, bad investments, or other factors, would be relegated to the public assistance rolls. The net result might well be to trade social security for "an enlarged [public assistance] program plus a compulsory savings plan."<sup>66</sup>

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<sup>61</sup> See Diamond, *supra* note 30, at 40-45.

<sup>62</sup> See, e.g., 1994-1996 ADVISORY COUNCIL REPORT, *supra* note 15, at 29 (progressive benefits under "individual account" (IA) plan); see *id.* at 31 (flat minimum benefit under "personal security account" (PSA) plan).

<sup>63</sup> See Hugh Heclo, *A Political Science Perspective on Social Security Reform*, in FRAMING THE SOCIAL SECURITY DEBATE, *supra* note 30, at 65, 88 (arguing that "privatized accounts will offer a ready-made vehicle for better-off workers to secede from the fate of other workers" and will "encourage a two-tier pension system that can easily evolve into a division of political constituencies between the weak and the strong"); Kathryn L. Moore, *Redistribution Under a Partially Privatized Social Security System*, 64 BROOK. L. REV. 969, 985 (1998) ("the real risk with partial privatization is the inexorable pressure it would create for full privatization.").

<sup>64</sup> See Michael J. Boskin et al., *Personal Security Accounts: A Proposal for Fundamental Social Security Reform*, in SOCIAL SECURITY AND PRIVATE PENSIONS: PROVIDING FOR RETIREMENT IN THE TWENTY-FIRST CENTURY 179 (Susan M. Wachter ed., 1988). A similar result could be achieved by making additional contributions to accounts of low-income participants from general revenues. See Laurence J. Kotlikoff et al., *Social Security: Privatization and Progressivity*, 88 AM. ECON. REV. 137 (1998).

<sup>65</sup> The Heritage Foundation report purports to retain the disability insurance component of the existing system. See BEACH & DAVIS, *supra* note 16, at 17, 20-21 (defending report's approach); KJAKAZI, *supra* note 25, at 22-25 (criticizing report's assumptions and methodology).

<sup>66</sup> 1994-1996 ADVISORY COUNCIL REPORT, *supra* note 15, at 71 (discussing risks of partial privatization with flat minimum benefit).

### C. TRANSITION COSTS

The Heritage Foundation report also ignores the transition costs of replacing the existing pay-as-you-go system with an advance-funded system of private accounts.<sup>67</sup> The existing system already has a built-in "unfunded liability," presently estimated at around \$9 trillion, which represents the net present value of future benefits already promised to current retirees and workers under the existing system based on their previously credited earnings.<sup>68</sup> If payroll taxes were diverted to private accounts for current workers, these promised benefits would presumably have to be financed by issuing new public debt, increasing taxes, or curtailing other public expenditures.<sup>69</sup> Thus, it appears that the transition to any sort of privatized system would involve large costs which in the near term would reduce or even eliminate the benefits of nominally higher rates of return under the new system. The method of financing the transition costs would determine how the burden would be spread among current and future generations.<sup>70</sup> Although abrupt tax increases or benefit cuts might seem preferable in terms of efficiency, there would undoubtedly be strong political pressure to impose transition costs as gradually and imperceptibly as possible, especially since the long-term benefits of privatization would not be immediately obvious.<sup>71</sup>

The existing system's unfunded liability can also be viewed in terms of the compounded value of intergenerational net transfers that occurred during the start-up phase when early generations of workers and their families received extraordinarily high rates of return.<sup>72</sup> As long as the payroll tax base continued to expand, the pay-as-you-go system made it possible to shift the cost of those transfers forward to successive genera-

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<sup>67</sup> See KIJAKAZI, *supra* note 25, at 15-17.

<sup>68</sup> See Stephen C. Goss, *Measuring Solvency in the Social Security System*, in PROSPECTS FOR SOCIAL SECURITY REFORM 16, 34 (Olivia S. Mitchell et al. eds., 1999) [hereinafter PROSPECTS FOR SOCIAL SECURITY REFORM].

<sup>69</sup> Some proponents of privatization have suggested that projected surpluses in the unified budget offer a one-time opportunity to finance transition costs. Those surpluses, however, are largely attributable to temporary accumulations of payroll tax revenues that have already been taken into account in measuring the existing system's unfunded liability. See R. Douglas Arnold, *The Political Feasibility of Social Security Reform*, in FRAMING THE SOCIAL SECURITY DEBATE, *supra* note 30, at 389, 414 (describing "stealth privatization" proposals).

<sup>70</sup> See 1994-1996 ADVISORY COUNCIL REPORT, *supra* note 15, at 28 (IA plan, proposing 1.6 percent private accounts funded from immediate payroll tax increase); *id.* at 32 (PSA plan, proposing 5 percent private accounts, with transition costs financed from 1.52 percent payroll tax increase over 72 years).

<sup>71</sup> See Arnold, *supra* note 69, at 397-408.

<sup>72</sup> Indeed, according to one study, despite the progressive tilt in the benefit formula, high earners have received the largest net transfers in absolute terms. See STEUERLE & BAKJIA, *supra* note 18, at 108, 110 (comparing social security to an imaginary "welfare system" in which "the rich received back tens of thousands of dollars for paying a few dollars of tax, while the very poor received a grant of a few hundred dollars without paying any taxes.").



tions of workers. As the baby boomers begin to retire, however, the payroll tax base will shrink relative to promised benefits. Thus, the low rates of return projected for current and future workers on their social security contributions are attributable to past net transfers rather than to waste or fraud in the existing system.<sup>73</sup> In calculating rates of return, the Heritage Foundation report takes the unfunded liability into account under the existing system while ignoring it under the privatized system. As a result, the report overstates the difference in the rates of return under the respective systems.

#### D. RISKS AND RETURNS

Like most privatization proposals, the Heritage Foundation report emphasizes the relatively high projected rates of return that could be achieved by investing in private capital markets.<sup>74</sup> The comparison with the existing system is potentially misleading, however, because the report fails to adjust the projected rates of return to reflect the risks of the different portfolios or the increased administrative costs of a privatized system. Compared to government bonds, private equities tend to have relatively high-expected yields which reflect correspondingly high levels of risk. Nevertheless, investors who hold optimally diversified portfolios presumably would not choose to invest more heavily in private equities, since doing so would increase their exposure to market risk above the existing (and by hypothesis already optimal) level. By contrast, constrained investors who would otherwise lack access to private capital markets might benefit from a diversified investment strategy.<sup>75</sup> For these investors, however, the potentially higher returns from diversification could be achieved even in a centralized fund without private accounts.<sup>76</sup>

A system of private accounts would offer individual workers a greater choice of investment strategies, but this flexibility would not be costless.<sup>77</sup> Presumably private accounts would be subject to annual fees to cover administrative costs. If structured as a flat annual charge, these

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<sup>73</sup> See Geanakoplos et al., *supra* note 57, at 144-48.

<sup>74</sup> The Heritage Foundation report, for example, assumes that workers could invest their private accounts in alternative investment portfolios ranging from private equities to government bonds. The report assumes real rates of return of 5.7 percent on equities, 2.8 percent on bonds, and 4.25 percent on a blended portfolio. See BEACH & DAVIS, *supra* note 10, at 18-19; BEACH & DAVIS, *supra* note 16, at 11-12.

<sup>75</sup> See Geanakoplos et al., *supra* note 57, at 151-52.

<sup>76</sup> See *id.* at 139. The main objection to achieving diversification through a centralized fund focuses on the perceived risks of "social investing" and government interference in corporate decision-making. See Theodore J. Angelis, *Public Investment in Private Markets: What Are the Right Questions?*, in FRAMING THE SOCIAL SECURITY DEBATE, *supra* note 30, at 287, 290-93, 304-10.

<sup>77</sup> See Olivia S. Mitchell, *Administrative Costs in Public and Private Retirement Systems*, in PRIVATIZING SOCIAL SECURITY 403, 404 (Martin Feldstein ed., 1998).

costs would fall disproportionately on smaller accounts;<sup>78</sup> as a result, low earners would receive lower rates of return on their investments even if they chose exactly the same investments as high earners. Alternatively, administrative costs could be structured as an annual charge equal to a fixed percentage of the balance in each account. As one recent study has pointed out, an annual charge of one percent of the balance in a private account could produce a net reduction of around 20 percent in the accumulated account balance over the course of a 40-year working career.<sup>79</sup> Compared to a centralized fund, a system of private accounts would likely incur substantially higher administrative costs that should be taken into account in projecting rates of return.

Even if a privatized system might ultimately produce higher rates of return for *many* workers, moving from a system of defined benefits to one of defined contributions would expose *individual* workers to unprecedented levels of investment risk. Workers with investment experience or simple good luck would receive the highest returns, while others would be left behind. In view of the strong positive correlation between income, education, and investment behavior, it seems likely that high returns would be concentrated among high earners. Even very prudent investors with well-diversified portfolios would experience volatile returns: short-term market fluctuations could produce substantial differences in the account balances of workers who reached retirement age at different times but were similarly situated in other respects.<sup>80</sup> Many workers, however, would not make prudent investment choices. Some would be tempted to take excessive risks in the hope of reaping extraordinary gains, while others would be unreasonably risk-averse. In either case, many workers would be disappointed with their investment outcomes and would presumably demand some sort of government guarantee or assistance to ensure an adequate retirement income.

Many proponents of privatization appear remarkably confident that a system of private accounts would spur workers to become successful investors. The experience with defined-contribution arrangements such as 401(k) plans and IRAs, however, suggests that this confidence may be

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<sup>78</sup> For example, assuming a flat annual fee of \$30, a worker with an annual wage of \$15,000 who made annual contributions of \$300 (i.e., 2 percent of payroll) to a private account that yielded a 5 percent rate of return would receive a negative rate of return for the first two years. See Francis X. Cavanaugh, *Discussion, in FRAMING THE SOCIAL SECURITY DEBATE*, *supra* note 30, at 319, 325; see also 1998 STATISTICAL SUPPLEMENT, *supra* note 12, at 173 tbl.4.B7 (in 1995, 46.69 percent of workers covered by social security earned less than \$15,000).

<sup>79</sup> See Diamond, *supra* note 30, at 54.

<sup>80</sup> See Lawrence H. Thompson, *Individual Uncertainty in Retirement Income Planning Under Different Public Pension Regimes*, in *FRAMING THE SOCIAL SECURITY DEBATE*, *supra* note 30, at 113, 127.

misplaced.<sup>81</sup> Although income and education appear to be better predictors of individual investment behavior than race, a system of private accounts would likely have varying impacts on different racial and ethnic groups.<sup>82</sup> Individuals with relatively low family incomes and little education tend to choose investments with lower levels of risk and correspondingly lower returns than those with higher incomes and more education.<sup>83</sup> Thus, it seems quite likely that groups with relatively low levels of income and education, including many black workers,<sup>84</sup> would receive disproportionately low returns under a system of private accounts.<sup>85</sup> It might be argued, of course, that black workers should welcome a new opportunity for private saving and capital formation, but this merely highlights existing gaps in financial assets<sup>86</sup> and investment experience.<sup>87</sup> If workers are to assume full responsibility for their own investment decisions, it seems appropriate, at the very least, to provide them with the necessary education and training to make prudent invest-

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<sup>81</sup> See *Social Security: Capital Markets and Educational Issues Associated With Individual Accounts, Report to the Chairman, House Comm. on Ways and Means*, 106TH Cong., 59 (1999) ("It is clear that among those who save through their company's retirement programs or on their own, there are large percentages of the investing population who do not fully understand what they are doing."); cf. B. Douglas Bernheim, *Financial Illiteracy, Education, and Retirement Saving*, in *LIVING WITH DEFINED CONTRIBUTION PENSIONS: REMAKING RESPONSIBILITY FOR RETIREMENT* 38, 43 (Olivia S. Mitchell & Sylvester J. Schieber eds., 1998) ("the existing literature demonstrates that most Americans know little about managing personal finances and their choices reflect this ignorance"). See generally Moore, *supra* note 31, at 16-20.

<sup>82</sup> See *SOCIAL SECURITY AND MINORITIES*, *supra* note 9, at 1 (statement of Cynthia M. Fagnoni); see also Bernheim, *supra* note 81, at 47 ("[d]ifferences based on gender and race are statistically significant, even holding other variables (such as education and earnings) constant").

<sup>83</sup> See *id.* at 1-2.

<sup>84</sup> See 1998 STATISTICAL ABSTRACT, *supra* note 17, at 405 tbl.648 (in 1997, 16.6 percent of black civilian workers were college graduates, compared to 29.5 percent of white civilian workers); *id.* at 436 tbl.696 (in 1997, full-time black workers had median weekly earnings of \$400, compared to \$519 for full-time white workers).

<sup>85</sup> See *Social Security and Minorities*, *supra* note 9, at 5 (statement of Cynthia M. Fagnoni) (finding that, controlling for family income and years of education, black IRA holders are "somewhat less likely" than whites to invest in stocks and mutual fund shares).

<sup>86</sup> See Marjorie Honig, *Minorities Face Retirement: Worklife Disparities Repeated?*, in *FORECASTING RETIREMENT NEEDS AND RETIREMENT WEALTH* 235, 235 (Olivia S. Mitchell et al. eds., 2000) (noting that, in 1993, net worth—including financial assets and housing equity, but not private pensions or social security—of median black household was less than one-tenth that of median white household); OLIVER & SHAPIRO, *supra* note 1, at 106-07 (noting that racial disparities in asset composition are greatest among low-income households); James P. Smith, *Racial and Ethnic Differences in Wealth in the Health and Retirement Study*, 30 J. HUM. RESOURCES S158, S167 (Supp. 1995) (noting that financial assets of average black household are "stunningly low").

<sup>87</sup> See Andrew F. Brimmer, *Income, Wealth, and Investment Behavior in the Black Community*, 78 AM. ECON. REV. 151, 154-55 (1988) (blacks tend to have relatively little experience with stock market investments due to economic, social, and cultural factors); Moran & Whitford, *supra* note 11, at 765 (noting racial disparity in stock and mutual fund holdings); see also Moore, *supra* note 31, at 21-23.

ment decisions. Unless all workers are properly equipped to take advantage of new investment opportunities, those opportunities may perpetuate existing racial inequalities. The Heritage Foundation report, however, fails to specify what measures, if any, would be taken to provide equal investment opportunities.<sup>88</sup>

#### E. DISABILITY INSURANCE AND AUXILIARY BENEFITS

A system of private accounts would pose special risks for disabled workers and their families. Proponents of privatization often ignore disability insurance since it is possible, in theory, to separate this component from the rest of the system.<sup>89</sup> Under a partially privatized system, disability benefits could be retained as part of a residual defined-benefit tier. This approach would generally require significant cuts in disability benefits, however, reflecting the reduced size of the defined-benefit tier.<sup>90</sup> Given the relatively high percentage of black workers and their families who receive disability benefits under the existing system, they would be especially hard hit by across-the-board cuts in these benefits.<sup>91</sup> Furthermore, even if workers could obtain supplemental disability insurance through private markets, the cost of such insurance would likely be highest for those with the greatest need.<sup>92</sup> The loss of disability benefits could be especially disastrous for workers who became disabled early in their working lives, since they would have little opportunity to accumulate adequate retirement savings in their private accounts.

Auxiliary benefits for spouses or survivors would presumably be scaled back in a partially privatized system, or eliminated entirely in a fully privatized system. The brunt of these reductions would fall on the groups that receive the greatest benefits under the existing system. Thus, for example, a reduction in spousal benefits would fall more heavily on

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<sup>88</sup> See *Social Security and Minorities*, *supra* note 9, at 6 (statement of Cynthia M. Fagnoni) ("It is not clear who would provide such information to workers under a restructured Social Security system that included mandatory individual accounts.").

<sup>89</sup> See *Social Security: Different Approaches for Addressing Program Solvency, Report to the Senate Comm. on Finance*, 105th Cong., 59 (1998) [hereinafter *Different Approaches*]. The Heritage Foundation report, for example, purports to carve out both contributions and benefits allocable to disability insurance from its analysis. See *supra* note 44 and accompanying text.

<sup>90</sup> See *Different Approaches*, *supra* note 89, at 60 (reporting that the PSA plan might reduce existing level of disability benefits by as much as 30 percent).

<sup>91</sup> See *supra* note 41 and accompanying text; KJAKAZI, *supra* note 25, at 23.

<sup>92</sup> See *Different Approaches*, *supra* note 89, at 59 (suggesting that under a voluntary private disability insurance program "comprehensive disability protection would be available to some only at a high price," due to problem of adverse selection); KJAKAZI, *supra* note 25, at 23 ("The greater the physical risk of the occupation and the less healthy the worker, the greater the probability of not qualifying for coverage and the higher the premium for those who do qualify.").

white married couples than on black married couples,<sup>93</sup> but a reduction in survivor benefits would fall especially heavily on black children.<sup>94</sup>

#### F. ANNUITIZATION

Proposals to convert social security to a system of private accounts also raise issues concerning the timing and form of distributions. Some privatization proposals would allow workers to make lump-sum withdrawals from their private accounts at any time during retirement and to leave any remaining balance at death to designated beneficiaries.<sup>95</sup> By contrast, other proposals would require that workers draw down their accumulated account balances in the form of an annuity at retirement, to ensure a regular stream of benefits throughout retirement.<sup>96</sup> If the primary goal of a privatized system is to provide retirement security for workers and their families, some degree of mandatory annuitization seems appropriate to prevent workers from dissipating their private accounts before death.<sup>97</sup> Indeed, in the case of married workers, there may be good reasons to provide protection for surviving spouses in the form of joint-and-survivor annuities, by analogy to the existing rules for qualified pension plans.<sup>98</sup> Nevertheless, full annuitization would increase the implicit subsidy to longer-lived groups (e.g., women, and especially white women) at the expense of shorter-lived groups (e.g., men, and especially black men).<sup>99</sup> A possible compromise solution would be to require annuitization of private accounts only up to a specified dollar

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<sup>93</sup> See *supra* notes 51-53 and accompanying text (noting racial impact of spousal benefits).

<sup>94</sup> See *supra* note 41 (noting racial impact of survivor benefits for children); *cf.* Moore, *supra* note 31, at 77 (curtailing surviving spouse benefits would affect "women of all races approximately equally").

<sup>95</sup> See, e.g., 1994-1996 ADVISORY COUNCIL REPORT, *supra* note 15, at 30, 32 (PSA plan). The Heritage Foundation report does not specify any restrictions on withdrawals from private accounts.

<sup>96</sup> See, e.g., *id.* at 28 (IA plan).

<sup>97</sup> By the same token, it would be important to resist political pressure to allow workers to tap their private accounts before retirement, since this would undermine the purpose of retirement saving. See Hecló, *supra* note 63, at 84-85 (pointing out that if restrictions against early withdrawal or borrowing are not maintained "many persons will likely reach retirement age with their personal accounts depleted for all sorts of good causes that occurred during their working lives"); Thompson, *supra* note 80, at 132 (noting that existing law permits early withdrawals for home purchases and for medical or educational expenses, with the result that "a substantial portion of what is set aside in individual retirement savings programs may be dissipated prior to retirement").

<sup>98</sup> See 1994-1996 ADVISORY COUNCIL REPORT, *supra* note 15, at 28 (IA plan, providing joint-and-survivor annuity as default option for married workers, subject to spousal waiver); see also Karen C. Burke & Grayson M.P. McCouch, *The Impact of Social Security Reform on Women's Economic Security*, 16 N.Y.L. SCH. J. HUM. RTS. 375, 398-402 (1999) (discussing role of joint-and-survivor annuities in protecting surviving spouses).

<sup>99</sup> Mandatory annuitization might help to bring down the overall cost of annuities by mitigating existing problems of adverse selection, but in any annuity system based on uniform

amount or percentage level. This approach would leave workers free to consume the rest of their accounts during retirement or dispose of them at death,<sup>100</sup> but would also raise politically sensitive issues concerning the required level of annuitization.<sup>101</sup>

### G. WEALTH DISPARITIES

For more than two decades, economists have debated whether social security significantly depresses private savings.<sup>102</sup> Despite the lack of professional consensus,<sup>103</sup> the Heritage Foundation report confidently asserts that the existing payroll taxes crowd out private savings: because the bulk of payroll taxes collected each year are paid out to current retirees and used for personal consumption, current workers (especially lower-income workers) are deprived of opportunities to save and invest productively.<sup>104</sup> By contrast, the Heritage Foundation report assumes that a privatized system would increase capital formation and spur investment: payroll taxes would be “transformed into investments, adding to the capital stock of the nation and enhancing productivity and economic growth.”<sup>105</sup> Apparently, the benefits of enhanced economic growth would eventually trickle down to lower-income workers.<sup>106</sup>

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mortality tables, the problem of different average life expectancies for various groups would remain.

<sup>100</sup> See Kent A. Smetters, *Thinking About Social Security's Trust Fund*, in PROSPECTS FOR SOCIAL SECURITY REFORM, *supra* note 68, at 201, 214 (arguing that full annuitization may not be optimal, and that “[a]t least some lump-sum disbursement will be desirable for the purpose of making a bequest, giving inter-vivos transfers to children (e.g., as a down payment on a house), or holding a buffer for medical and non-medical expenses faced by beneficiaries and their heirs”).

<sup>101</sup> If the required level were set too high, the effect would be indistinguishable from full annuitization for many workers. On the other hand, if it were set too low, the government might be called on to guarantee a minimum annuity benefit, which would raise problems of cost and moral hazard.

<sup>102</sup> The debate involves the net effect of two opposing forces. On one hand, to the extent that social security benefits are perceived as a replacement for other household wealth, private savings may decline (the “replacement effect”); on the other hand, to the extent that social security benefits induce early retirement, they may actually increase private savings by encouraging individuals to save more over a shorter working career to finance a longer retirement (the “retirement effect”). See Burke & McCouch, *supra* note 14, at 1242-43.

<sup>103</sup> See *id.* at 1242 & n.199 (citing studies and noting that evidence concerning the magnitude of social security's effect on savings is “at best ambiguous and inconclusive”).

<sup>104</sup> See BEACH & DAVIS, *supra* note 10, at 5 (“today the high payroll taxes needed to pay those current benefits crowd out private retirement investments”); *id.* at 6 (arguing that social security acts as “a drag on future generations” by “taxing away one generation's opportunity to help the next generation start earning at a higher level”); *id.* at 15 (“Social Security taxes are consumed primarily in paying benefits to current retirees who spend nearly all of their income on personal consumption items”).

<sup>105</sup> *Id.* at 15.

<sup>106</sup> See *id.* at 16 (arguing that increased saving and investment by higher-income workers in a privatized system could “quite possibly” provide employment for other workers).

The Heritage Foundation report's attempt to blame social security for low savings among lower-income workers seems disingenuous.<sup>107</sup> This line of attack echoes the charge of "over-annuitization" leveled against social security by critics who argue that lower-income workers have little incentive to save for retirement if their future consumption opportunities compare favorably with their current circumstances.<sup>108</sup> Much the same could be said of any other program that seeks to provide a social safety net.<sup>109</sup> By logical extension, it could be argued that work effort and private savings would be increased by dismantling social security altogether.<sup>110</sup>

The persistent racial gap in household wealth defies easy explanation.<sup>111</sup> Conventional measures of household wealth focus on "personal net worth," which includes both financial assets and consumption-type assets net of liabilities.<sup>112</sup> In measuring the distribution of wealth at retirement, however, economists tend to define household wealth more broadly to embrace the present value of expected social security benefits

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<sup>107</sup> See BEACH & DAVIS, *supra* note 10, at 5-6 ("The inability of poor workers to accumulate enough savings to leave a nest egg to their children can mean that their children will be as dependent as their parents could be on their monthly Social Security check. It means that poor communities will not have as much 'home grown' capital with which to create new jobs and sources of income.").

<sup>108</sup> See Martin Feldstein, *Social Security, Induced Retirement, and Aggregate Capital Accumulation*, 82 J. POL. ECON. 905, 920 (1974) ("For middle- and low-income families, social security is a complete substitute for a substantial rate of private saving."). *But cf.* KATHLEEN MCGARRY & ANDREW DAVENPORT, PENSIONS AND THE DISTRIBUTION OF WEALTH 13 (National Bureau of Economic Research Working Paper No. 6171, 1997) (disputing claim of over-annuitization).

<sup>109</sup> See R. Glenn Hubbard et al., *Precautionary Saving and Social Insurance*, 103 J. POL. ECON. 360, 372 (1995) ("lower-income households may rationally accumulate proportionately less than higher-income households because of the existence of an asset-based, means-tested social insurance 'safety net'").

<sup>110</sup> See Martin Feldstein, *The Missing Piece in Policy Analysis: Social Security Reform*, 86 AM. ECON. REV. 1, 8 n.26 (1996) (suggesting that "the optimal level of Social Security benefits may be zero").

<sup>111</sup> See Smith, *supra* note 86, at S166 ("we know far more about racial and ethnic income deficits than about the corresponding wealth disparities"); *id.* at S180 (noting that "minority wealth disparities are due in part to differential inheritances and desired bequests as inequities perpetuate themselves across generations [and] to lower minority incomes and poorer health"); Francine D. Blau & John W. Graham, *Black-White Differences in Wealth and Asset Composition*, 105 Q.J. ECON. 321, 332, 334 (1990) (rejecting hypothesis that wealth disparities are primarily attributable to racial differences in saving behavior, and suggesting that differences in intergenerational transfers are more likely explanation); see also OLIVER & SHAPIRO, *supra* note 1, at 50 ("Wealth is one indicator of material disparity that captures the historical legacy of low wages, personal and organizational discrimination, and institutionalized racism.").

<sup>112</sup> See Honig, *supra* note 86, at 244-45. Net financial assets may be more reliable than personal net worth as an indicator of a household's power to accumulate additional wealth. See Moran & Whitford, *supra* note 11, at 767-68 ("Net financial assets are most likely to produce additional income and wealth."); OLIVER & SHAPIRO, *supra* note 1, at 58-59 (noting that consumption-type assets are unlikely to be converted into other forms of wealth).

and private pensions in addition to personal net worth.<sup>113</sup> Since social security benefits are more equally distributed across racial groups than personal net worth and private pensions,<sup>114</sup> it is hardly surprising that the racial gap in household wealth narrows substantially when social security is taken into account.<sup>115</sup> The Heritage Foundation report ignores the effect of social security benefits in mitigating racial wealth disparities at retirement. Despite this equalizing effect, wealth disparities between black and white households that arise during working years are likely to continue during retirement. Given that the median black household may have less than half the wealth of its white counterpart at retirement,<sup>116</sup> replacing social security with a system of private accounts would likely have a significant adverse impact on standards of living during retirement for many black households.

By ignoring transition costs, the Heritage Foundation report manages to portray full privatization as a “win-win” proposition offering higher private saving, investment, and economic growth for future generations with no acknowledged sacrifice in living standards for current generations. To the extent that current generations would bear the transition costs, however, their levels of consumption would inevitably be reduced. Proponents of full privatization may believe that a reduction in the living standards of current workers is an acceptable price for the long-term benefits of economic growth. However, the inherent tradeoff between the well-being of current and future generations should be addressed explicitly, especially if future generations are likely to be better off in any event due to rising productivity and technological advances.<sup>117</sup>

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<sup>113</sup> See Honig, *supra* note 86, at 237; Smith, *supra* note 86, at S159.

<sup>114</sup> See Smith, *supra* note 86, at S178; see also Honig, *supra* note 86, at 243. While private pension wealth is more evenly distributed than total wealth, significant racial disparities persist. See Honig, *supra* note 86, at 245 (“it is the inclusion of social security wealth, not pension wealth, that narrows the gap between white and minority households”); see also INCOME OF THE POPULATION 55 OR OLDER, *supra* note 2, at 13 tbl.L5 (reporting that in 1996, 4 percent of units age 65 or older in the lowest income quintile, compared to 43 percent of those in the highest quintile, received income from private pensions or annuities).

<sup>115</sup> One recent study found that, taking only personal net worth into account, mean household wealth of black households was only 2 percent of that of white households; taking social security and private pension benefits into account, however, brought the ratio up to 46 percent. See Smith, *supra* note 86, at S179 (noting that social security wealth comprises over 40 percent of total black household wealth, compared to only 25 percent of white household wealth); see also Honig, *supra* note 86, at 245-46.

<sup>116</sup> See Honig, *supra* note 86, at 245-46 (even taking into account social security and private pension wealth, the expected level of wealth at retirement for the median black household is still less than half that of the median white household); see also *id.* at 246 (“in many black households, the role of second earners in financing post-retirement consumption may be pivotal”).

<sup>117</sup> See Geanakoplos et al., *supra* note 57, at 150 (arguing that the focus of debate should be on identifying and comparing tradeoffs rather than on whether there is a “free lunch”).



The Heritage Foundation report seeks to buttress its capital-formation argument by suggesting that a privatized system would allow black households to achieve an optimal level of bequests.<sup>118</sup> This is essentially a variant of the over-annuitization argument. Proponents of privatization often maintain that individual workers should be allowed to choose what portion, if any, of their retirement assets to annuitize. Retirees who choose "a more thrifty life style than the general public might deem appropriate" would then be free to pass on their accumulated retirement wealth to their heirs.<sup>119</sup> According to this view, mandatory annuitization tends to interfere with bequest motives, leading to higher levels of retirement consumption and smaller bequests.<sup>120</sup>

Given the pronounced racial disparities in income and wealth, a similar disparity in bequests should come as no surprise.<sup>121</sup> The relative paucity of bequests among black households may be explained, at least in part, by differences in savings attributable to lower lifetime income and poorer health. In addition, since black workers tend to have shorter-than-average life expectancies, the effect of mandatory annuitization is to decrease their net bequeathing power.<sup>122</sup> Thus, Heritage Foundation's claim concerning the effect of social security on bequests may merely reiterate the point that mandatory annuitization involves a mortality gamble which benefits longer-lived groups at the expense of shorter-lived groups. To the extent that mortality risks are skewed, they could be neutralized by providing mandatory life insurance.<sup>123</sup> This does not imply, however, that a system of retirement security should not require at least some level of annuitization.

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<sup>118</sup> See BEACH & DAVIS, *supra* note 10, at 16 (suggesting that a privatized system might enable a hypothetical black worker to nearly double her rate of return under the existing system "and pass on the remainder. . .to her children"); see also MARTIN FELDSTEIN & ELENA RANGUELOVA, *THE ECONOMICS OF BEQUESTS IN PENSIONS AND SOCIAL SECURITY* 2 (National Bureau of Economic Research Working Paper No. 7065, 1999) (private accounts would "give middle and lower income individuals the opportunity to accumulate wealth and make significant bequests"); *id.* at 3 (justifying mandatory savings as a means of "helping individuals to make the bequests that they would like to make but lack the ability to achieve").

<sup>119</sup> 1994-1996 ADVISORY COUNCIL REPORT, *supra* note 15, at 117 (statement of Joan T. Bok).

<sup>120</sup> See *id.* The underlying assumption is apparently that there is a higher marginal propensity to consume social security wealth than other "ordinary" wealth. See Feldstein, *supra* note 108, at 916 ("a large portion of ordinary wealth is held by a small fraction of households for whom bequests and the accumulation of larger fortunes are more important than saving for retirement").

<sup>121</sup> See Smith, *supra* note 86, at S176 (nearly one in three white households reported a financial inheritance, compared to one in ten minority households); Moran & Whitford, *supra* note 11, at 772 (noting racial disparity in gifts and inheritances).

<sup>122</sup> Workers with relatively short life-spans receive a correspondingly short stream of annuity payments. In addition, mandatory annuitization may undermine bequeathing power to the extent that there is a greater marginal propensity to consume annuitized wealth than other types of wealth. See *supra* note 120 and accompanying text.

<sup>123</sup> See *supra* notes 30 & 31 and accompanying text.

More broadly, the argument for bequest-oriented saving reflects a view of private accounts as vehicles for accumulating unrestricted personal wealth rather than as an earmarked source of retirement income.<sup>124</sup> Bequest motives appear to be strongest among households with the highest levels of income and wealth, which are overwhelmingly white. Since these households already enjoy the most favorable opportunities to accumulate dynastic wealth, it seems odd—indeed, perverse—to design a privatized social security system in a manner that would increase preexisting wealth disparities. Instead, if the goal of providing equal opportunity for saving and capital formation is taken seriously, it may be time to consider more direct methods to reduce racial disparities in household wealth outside the social security system.<sup>125</sup>

### CONCLUSION

Social security provides important benefits to retired or disabled workers and their families. The existing system, however, cannot be sustained indefinitely without increasing taxes or cutting benefits. Reform of some sort appears inevitable. Because the existing system contains several redistributive features that work to the advantage of some groups and to the detriment of others, any change is likely to produce both winners and losers. The direction of future reform is of special concern to black workers. Some proponents of privatization claim that black workers receive especially low rates of return on their contributions under the existing system and would fare better under a defined-contribution system of private accounts. On closer examination, however, this claim turns out to be potentially overstated and misleading. Some aspects of the existing system work to the advantage of black workers as a group, while others do not. Overall, the impact of the system appears to be progressive, though less so than might at first appear.

At a more fundamental level, it seems inappropriate to measure the performance of the existing system exclusively in terms of rates of return on contributions. Social security strikes a balance between competing goals of social adequacy and individual equity. From its inception, the program has produced large-scale redistribution within and among generations; it was never intended to maximize rates of return for all workers on their contributions. To argue, as some privatizers do, that the existing system is a failure because it does not maximize private saving and capi-

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<sup>124</sup> See Peter A. Diamond, *Macroeconomic Aspects of Social Security Reform*, in 2 BROOKINGS PAPERS ON ECONOMIC ACTIVITY 1, 45 (1997) (noting political issues raised by contrasting views of “wealth entitlement” and “retirement income entitlement”).

<sup>125</sup> See OLIVER & SHAPIRO, *supra* note 1, at 9 (suggesting a need for “massive redistributive policies”); Moran & Whitford, *supra* note 11, at 802-03 (urging reexamination of racially-skewed tax provisions).

tal formation misses the point that social security has proved remarkably successful in keeping nearly 40 percent of elderly Americans out of poverty. In view of the goals of social security, a more pertinent inquiry is whether a system of private accounts would adequately protect retired or disabled workers and their families against the risk of lost earnings. Of course, the answer depends largely on details of design and implementation that have yet to be fully elaborated. Nevertheless, there is good reason for many workers, and especially black workers, to be concerned about the implications of radical privatization. A fully privatized system might ultimately yield higher overall returns for future workers, but it would also expose individual workers to significant market risks and might well exacerbate existing racial inequalities in income and wealth. Moreover, the transition would be very costly. By comparison, the existing system may prove not to be such a bad deal after all.