INSTITUTE FOR WOMEN'S POLICY RESEARCH

Research-in-Brief

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Why Privatizing Social Security Would Hurt Women

Social Security reform is a women's issue. Women make up 60 percent of Social Security beneficiaries, and they depend more heavily on Social Security than men do for their income in retirement. Half of the women aged 65 and older would be poor if not for Social Security. For 25 percent of elderly women who live alone, Social Security is their only source of income. (For an explanation of the benefits for women under the current Social Security system, see Table 1.)

Whether Congress should "reform" Social Security into a system of personal retirement accounts or strengthen it in its current form has particular importance to women. Both advocates for and against privatization claim their proposals benefit women. Among privatizers, the Cato Institute has been particularly vocal in courting women's support. In a 1998 memorandum to the Institute for Women's Policy Research, the Cato Institute claimed that its proposals meet the National Council of Women's Organizations' (NCWO) "check list" for Social Security reform and hence deserve NCWO's support.

This fact sheet refutes this claim, drawing attention to four central problems with privatizing Social Security: increased risk, the high costs associated with the transition from a pay-as-you-go to a pre-funded system, and the high costs of administrating individual accounts and purchasing life and disability insurance in the private market. Table 2 responds to the Cato Institute's claims regarding the NCWO's principles for Social Security reform point by point and concludes that privatizing Social Security would hurt, not help, most women.

Why Privatizing Social Security Isn't a Good Idea for Anyone

At the core of the Cato Institute proposals is the assumption that the historically high rate of return of the stock market will continue indefinitely. However, the future value of stocks is notoriously difficult to predict. In fact, the stock market may well be at a peak, and many stocks may be overvalued. Given the slower future economic growth predicted by many experts (including the Social Security Trustees), and the high current valuations of many stocks, it is difficult to see how future rates of return could continue to be so high. Moreover, to the extent that equities represent a better investment, workers could benefit from them with less risk and lower administrative costs if the investments were made collectively. Government could accumulate reserve funds in the Social Security trust funds and invest part of these reserves in private stocks and bonds.

A second problem associated with privatizing Social Security is the cost of the transition from a "pay-as – you-go" to a pre-funded system. About 90 percent of current payroll taxes are used to pay current retirees, disabled workers, and survivors. If pre-funded individual accounts were adopted, the generation(s) living through the transition would have to pay for two systems at once, both the retirement for their parents and grandparents and their own retirement.

The failure to fully account for the cost of administering individual accounts is another fundamental flaw in the Cato Institute's proposals. Munnell (1999) estimates that individual accounts would at least double administrative costs. Evidence from other countries that have experimented with privatizing Social Security confirms that administrative costs are much higher for individual account based systems than for traditional defined benefit programs like the current U.S. system(see Congressional Budget Office 1999; Diamond 1998). Evidence from other countries that have experimented with privatizing Social Security confirms that administrative costs are much higher for individual accounts than for traditional defined benefit style programs (see Congressional Budget Office 1999; Diamond 1998). Because many transaction fees involve a flat per account charge, administrative costs would consume a larger portion of the accounts of low- and moderate-income families.

The Cato Institute also fails to account for the full cost of replacing the disability and life insurance component of Social Security. Social Security provides life and disability insurance to all workers and their families. The Cato Institute assumes that everyone can purchase individual policies from private companies. However, the Cato Institute fails to recognize that it is unlikely that private companies would offer the extensive coverage provided by the current system at an affordable rate. For people with pre-existing conditions, life and disability insurance may not be available at any price.

Why Privatizing Social Security Would Be a Particularly Bad Idea for Women

There are several reasons why individual accounts would be particularly negative for women. First, because women earn less than men, they benefit from the current system that provides proportionately higher benefits for low earners. This feature would be lost in a privatized system. Because women would tend to have smaller accounts, it is likely that the yield of their accounts would be below average, as they (appropriately) avoid risky investments. For these same reasons, women would find a larger share of their accounts going toward administration. Second, because women tend to live longer than men, they would have to pay more for annuities (guaranteed monthly income) in a privatized system, or face the possibility of outliving their assets. Finally, women are more likely to be hurt by losses in disability and life insurance coverage because they are much more likely to be responsible for children as well as themselves after disability or death.

Table 1: Current Social Security System's Retirement Benefits

- The current Social Security system is a pay-as-you-go system, meaning that current payroll taxes are used to pay benefits to current retirees. In 1983, Congress introduced an element of pre-funding by adopting an increase in payroll taxes that meant that Social Security would take in more tax revenue than it paid out, with the surplus dedicated to supplementing tax revenue when the baby boomers begin to retire.
- Social Security benefits are based on the 35 years of highest taxable earnings. The benefit formula is a progressive calculation that replaces a higher percentage of earnings for low income workers than for high earners. Benefits are adjusted annually to account for inflation and are paid as long as the recipient lives.
- Currently, the retirement age for full benefits is 65, and the earliest age at which one is eligible for benefits is 62. Early retirement results in reduced benefits. The eligibility age for full Social Security benefits has been revised from 65 to 67 years of age, to be phased in by the year 2022.
- Under the current system, a married person is eligible for the larger of either 100 percent of his or her own retired worker benefit or 50 percent of his or her spouse's retired worker benefit. A woman whose benefit based on her own work record is less than or equal to the spousal benefit she could claim is said to be "dually entitled" and does not gain additional benefit from having worked. Men are similarly entitled to benefits from their wives' accounts, but in practice nearly all who use the spouse's benefit are women.
- Widow(er)s are entitled to 100 percent of the deceased spouse's retired worker benefit, if it is larger than his or her own retired worker benefit.
- A divorced person who was married for at least 10 years, who is not married at 62 and whose former spouse is still living, is entitled to spousal benefits equal to 50 percent of the former spouse's retired worker benefit (if it is greater than 100 percent of her or his own retired worker benefit). Divorced persons married at least 10 years are also entitled to survivor benefits when the former spouse dies, at the 100 percent rate that applies to widow(er)s.
- Social Security also provides disability and life insurance to all covered workers.

Table 2: A Response to the Cato Institute's Proposal based on the National Council of Women's Organizations (NCWO) Principles for Social Security Reform

Principle 1: Help lower life-time earners

Cato Institute's claim	Why the Cato Institute is wrong
◆ "Even taking into account Social Security's "progressive" benefit structure, all categories of women would still get more for their money under a fully private plan" (Olsen: 1998a, 10). ◆ "The freedom to choose is particularly important to low-wage women who do not earn enough to save and invest on their own. That inability to invest is largely due to high payroll tax rates. Forcing women to stay in a system that takes 12.4 percent of their wages only to cheat them of a secure retirement is simply unjust" (Olsen 1998a, 11-12).	◆ The Cato Institute uses examples for low earners based on 40 years of full-time work at wages that are at or above the bottom third for all workers; an interrupted career is defined as 35 years of full-time work (Olsen 1998a, footnote 24 and 27, p. 17; Shirley and Spiegler 1998). However, of workers retiring in 1996, the median woman had worked 27 years over her lifetime. Thus, the income (and retirement contributions) of the Cato Institute's "low life-time earners" is unrealistically high. ◆ The Earned Income Tax Credit offsets payroll taxes for many low earners in the current Social Security system. ◆ Because low earners have less money to invest and cannot afford risky investments, it is likely that they will have lower rates of return on their individual accounts.

Principle 2: Maintain cost-of-living adjustments (COLAs)

Cato Institute's claim	Why the Cato Institute is wrong
◆ Women could buy inflation-adjusted annuities.	◆ Inflation-adjusted annuities, if available at all, would be very expensive. Moreover, women would pay more for annuities than men because they tend to live longer. A woman who is 65 today can expect to live to 84, while a 65 year old man can expect to live only to 81 years of age.

Principle 3: Protect and strengthen benefits for wives, widows, and divorced women

Cato Institute's claims	Why the Cato Institute is wrong
◆ The Cato Institute has proposed earnings sharing or joint ownership of private accounts to improve women's benefits and to address the inequities between traditional one earner	◆ Earnings sharing requires the elimination of the spousal benefit. ◆ Earnings sharing proposals may impoverish

households and dual earner couples (Olsen 1998c).

those divorced wives who would only benefit from the husbands' earnings for the period they were married. Children would also be eligible only for the benefits earned during their parent's marriage.

- Earnings sharing would increase administrative costs.
- There are other avenues for improving equity among different kinds of households (see Hartmann and Hill, forthcoming).

Principle 4: Preserve disability/survivor benefits

Cato Institute's claim	Why the Cato Institute is wrong
◆ Individuals can purchase disability and life insurance in the private market.	◆ Private insurers may not offer policies to people whom they consider "high risk" for disability or death such as those with known health risks or workers in dangerous occupations. ◆ Premiums for disability and life insurance, when it is available, may be prohibitively expensive for many low income workers.

Principle 5: Protect the most disadvantaged workers from across-the-board cuts

Cato Institute's claim	Why the Cato Institute is wrong
◆ Because benefits from individual accounts would be determined by the market rather than by Congressional edict, benefits are better protected for everyone.	◆ Individual accounts expose workers and their families to market risks. ◆ Political risks remain for disadvantaged workers who would have to depend on the safety net because their personal accounts would be too small. Eligibility for such means-tested support, and the level of support, would definitely be a political matter.

Principle 6: Insure that women's guaranteed benefits are not reduced by individual account plans that are subject to the uncertainties of the stock market

Cato Institute's claim	Why the Cato Institute is wrong
◆ The stock market has performed consistently	◆ Cato presents average returns; returns on

well (Shirley and Spiegler 1998). Risks are manageable and there is no reason to assume that women won't be able to invest as well as men (Olsen 1998b).

- Minimum benefits will protect workers.

individual counts will, of course, vary. Evidence from the experience with privatization in the United Kingdom suggests that misleading advertising is a serious problem. Regulation of the industry is another cost to government not accounted for by the Cato Institute.

- Minimum benefit levels may not be enforced or may be reduced over time. No realistic accounting of the cost of providing guaranteed minimum benefits has been put forward by the Cato Institute.

Principle 7: Address the care-giving and labor force experience of women

Cato Institute's claim

- The Cato Institute argues that earnings sharing or joint ownership of individual accounts would fairly reward women's care giving work in the family, as the default division of credits would be 50/50.

Why the Cato Institute is wrong

- Earnings sharing rewards women who marry (and stay married for a long time) to men who make high incomes, as do current spousal benefits. Earnings sharing and individual accounts do nothing for single mothers or gay couples, and little for women who are married for short periods of time.

Principle 8: Reduce the number of elderly women in poverty, especially women who live alone

Cato Institute's claim

- "All serious proposals for privatization include a safety net feature that would ensure that everyone's retirement income is at least at or above the poverty line" (Olsen 1998b, 2).

Why the Cato Institute is wrong

- Not all of the Cato Institute's privatization proposals include such a minimum. Furthermore, it is unlikely that Congress would pass such a dramatic improvement in benefits. Currently Social Security's special minimum is approximately 85 percent of the poverty line. For workers who have less than 30 years of coverage the benefit gradually decreases and phases out at 10 years. SSI's maximum benefit for a single individual is even less (about 75 percent of the poverty line) and is subject to means and asset tests.

- A minimum benefit at or above the poverty line is, of course, desirable. However, the Cato Institute has provided no estimate of the cost of such a minimum.

Note: The order of the National Council of Women's Organizations principles has been changed to improve the flow of the discussion. The content of the principles has not been altered. See NCWO's web site (http://www.womensorganizations.org) and the web site of its Task Force on Women and Social Security (http://www.women4socialsecurity.org) for further discussion of these principles. All Cato publications can be found at http://www.cato.org.

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The Institute works with policymakers, scholars, and public interest groups around the country to design, execute, and disseminate research that illuminates economic and social policy issues affecting women and families, and to build a network of individuals and organizations that conduct and use women-oriented policy research. IWPR, an independent, nonprofit organization, also works in affiliation with the graduate programs in public policy and women's studies at The George Washington University.

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