

State of the U.S. Social Security Program

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How the System Works

- Pay-as-you go.
 - Workers of today support workers of yesterday.
- At the moment, the social security trust fund has an accumulated surplus of about \$2 trillions.
 - US Treasury borrows social security surplus and writes IOUs.
 - US Treasury pays interest on the borrowings in the form of IOUs.

Changing Population Profiles

- Due to improvements in living conditions and medical services people are living longer. As a result:
 - In 1950 there were 16 workers to support each social security recipient.
 - In 2005 there are about 3.3 workers to support each social security recipient.
 - By the time today's young workers retire (2042-2052) there will be 2 workers to support each social security recipient.

Changing Population Profiles



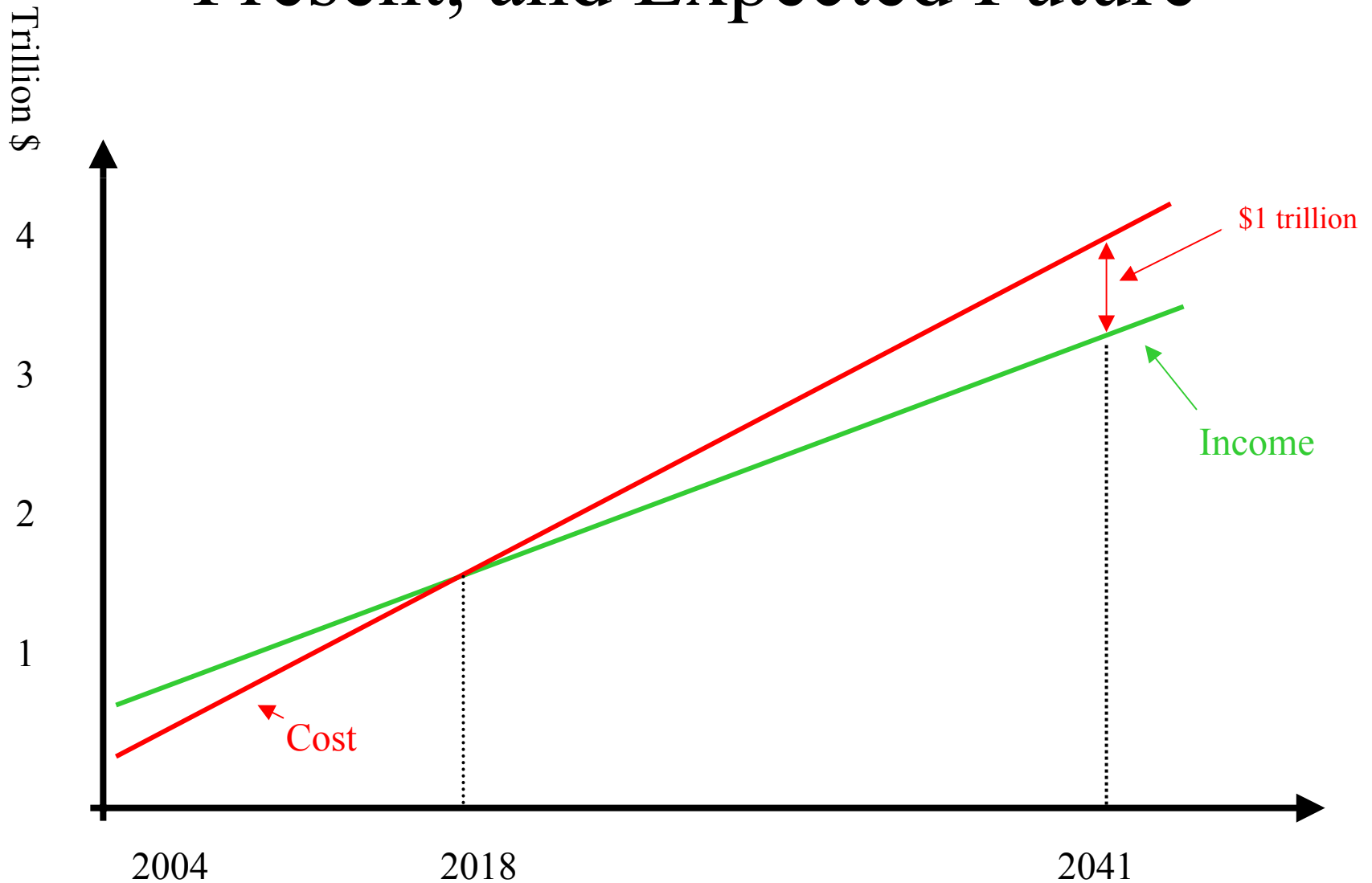
A Snapshot (December 2004)

- 69% of social security recipients are retired workers.
- 17% of social security recipients are disabled workers.
- 14% of social security recipients are the survivors of the deceased workers.
- 22% of social security recipients consider it their only source of income.
- 66% of social security recipients consider it their major source of income (50% or more).
- On average each social security recipient gets \$872 per month.

Projections

- If changes are not made sooner, benefits of individuals retiring around 2042-2052 will have to be cut by 30%. Govt. actuaries project that government has promised \$3.7 trillions (in 2005 dollars) more than the expected revenue. These projections depend upon:
 - Life span
 - Economic growth
 - Wages
 - immigration

Present, and Expected Future



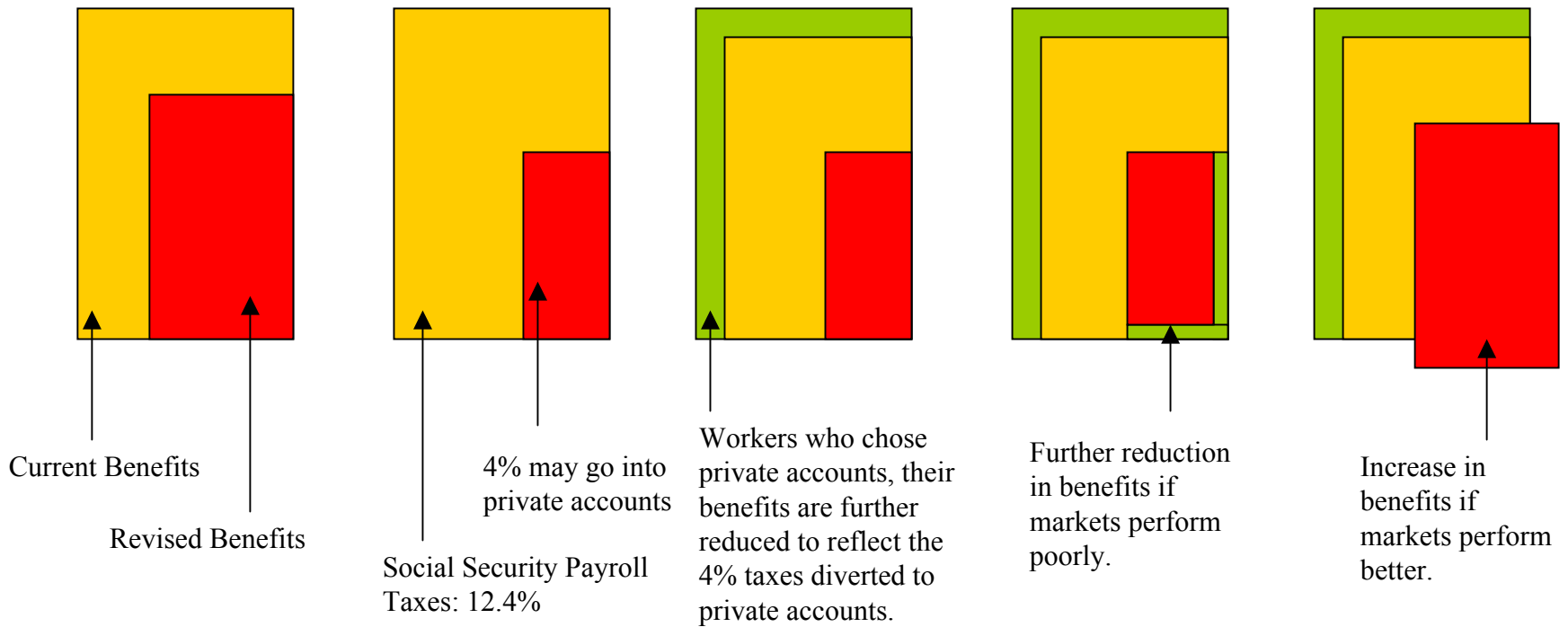
Tax Increases or Benefit Cuts?

- To stabilize the system for another 75 years, taxes may be increased from today's 12.4% to about 13.9%.
- If we increase the current ceiling of 90,000 to 140,000 over a decade, 40% of the Social Security problem will be solved.
- To stabilize the system for another 75 years, benefits may be reduced by 13%.

The Bush Plan

- Individuals who are younger than 55 will have:
 - Reduction in benefits, low wage workers, disabled workers and widows may get higher benefits than the rest.
 - May divert 4% of payroll taxes into private accounts—up to \$1000 per year.
- However, nothing specific yet.

The Bush Plan



The Costs

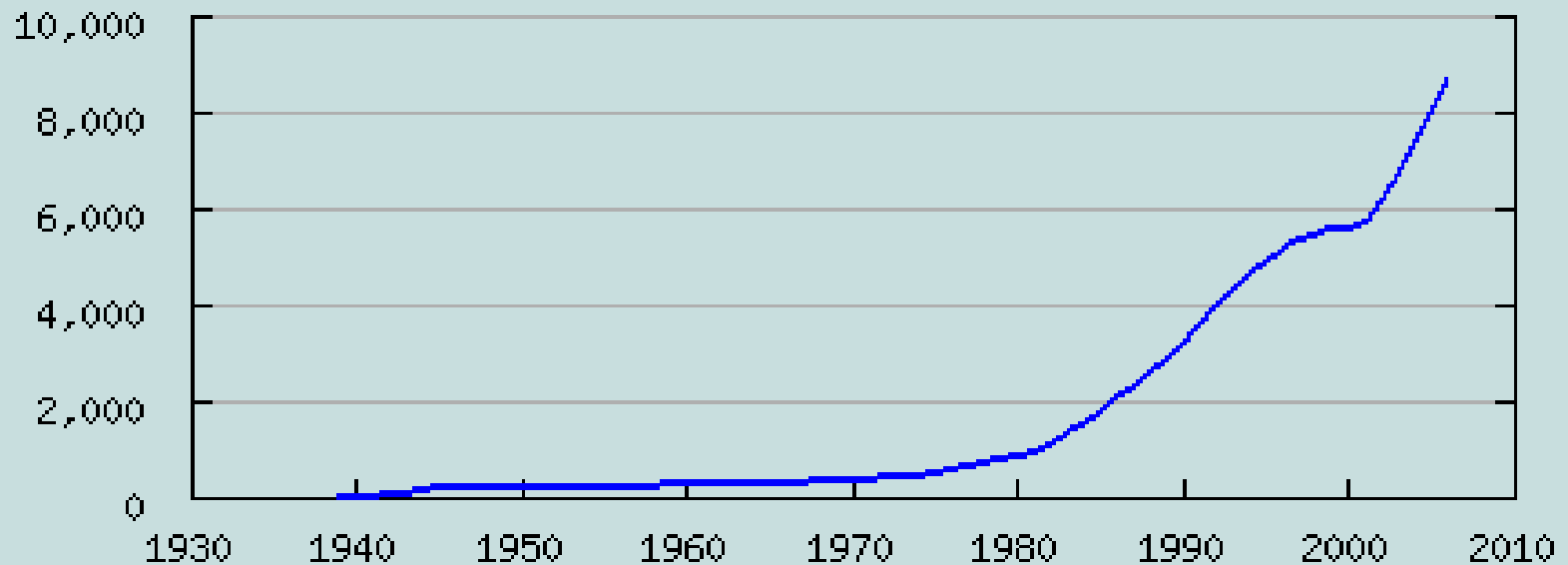
- Recall that under the current Social Security program, benefits of retirees are paid for by the individuals working today.
- If taxes are diverted to private accounts, government must find another way pay for the benefits of retirees.
- The White House proposes borrowing \$1 to \$2 trillion over the next 10 years.
- In the long-run, private accounts will probably be a wash—government has to pay lower benefits but it also receives lower tax revenue.
- Unless government is forced to provide a security net in the event that markets perform poorly.

Federal Budget Deficit Picture

- Alan Greenspan, testifying before the House budget committee on March 2, 2005, called for “major deficit reducing actions.”
- He said, “In my judgment, the necessary choices will be especially difficult to implement without the restoration of a set of procedural restraints on the budget making process.”

Gross Federal Debt

Gross Federal Debt
(Billions of Dollars)
Source: The White House: Council of Economic Advisors

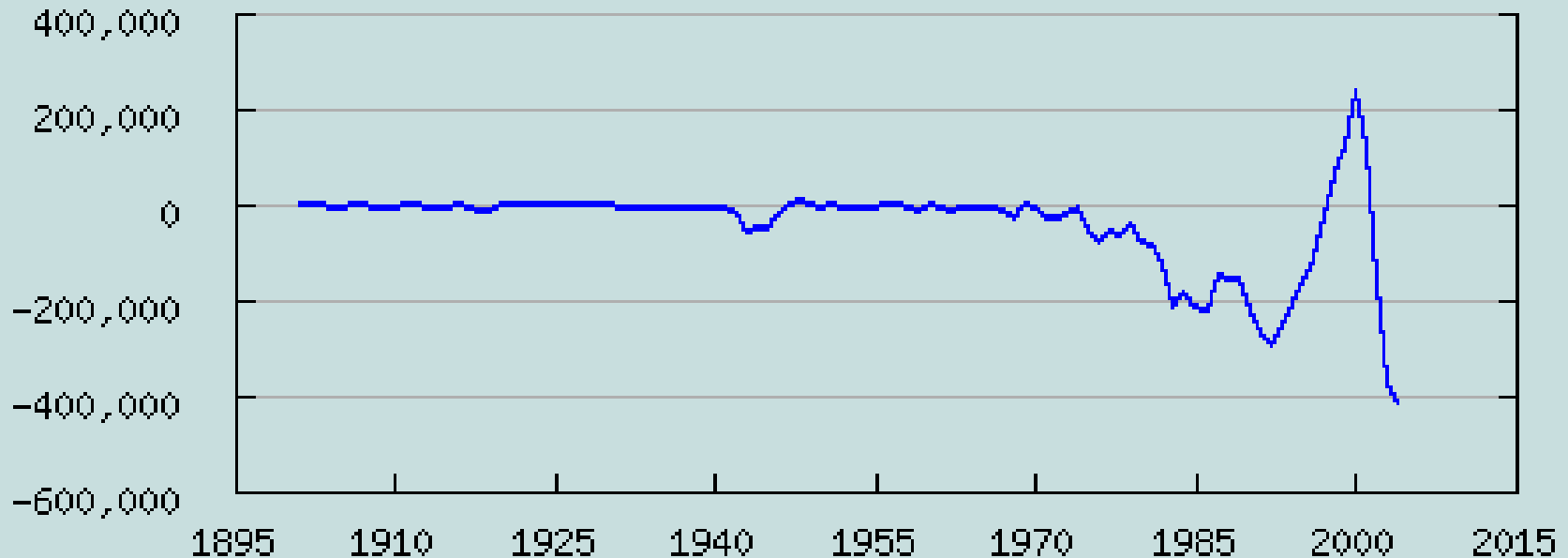


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Federal Deficit

Federal Surplus or Deficit [-]
(Millions of Dollars)

Source: The White House: Office of Management and Budget

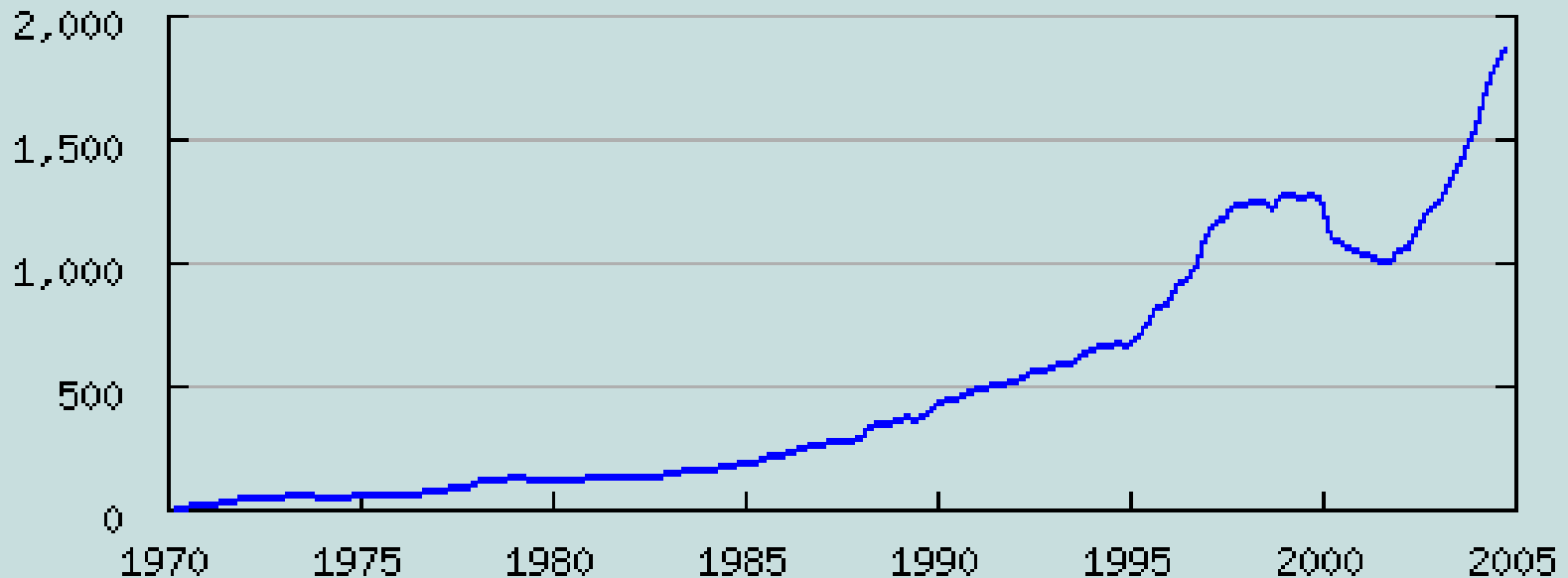


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Federal Debt Held by Foreign and International Investors

Federal Debt Held by Foreign & International Investors
(Billions of Dollars)

Source: U.S. Department of the Treasury, Financial Management Service



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Will Private Accounts be Enough?

- “There has been too much attention focused on individual accounts as part of Social Security reform. By themselves they will not deal with the solvency and sustainability issue. This comes down to benefits cuts or revenue increases.” David Walker, US Comptroller General and head of the Government Accountability Office.

Some Alternative Proposals (1)

- Peter Diamond and Peter Orszag (economists):
 - “raise payroll taxes to 14.2% (split between employer and employee) by 2055.”
 - “increase the base on which taxes are levied.”
 - “lift the age for the full retirement benefit.”
 - “trim benefits for higher-income recipients while increasing them for low-income workers.”

Some Alternative Proposals (2)

- Robert Pozen (former Fidelity Investments vice chairman):
 - Use the Bush plan but
 - Make more generous for low-income workers
 - Make less generous for high-income workers

Some Alternative Proposals (3)

- Senator Lindsey Graham (R)
 - If you are under 55
 - Either stay in the current Social Security program and pay 2% more in payroll taxes
 - Or take lower benefits
 - Or divert 4% to private accounts and accept lower benefits
 - If you choose the private-account option, you will be guaranteed a retirement benefit of 20% above the poverty line.

Some Alternative Proposals (4)

- Representative Paul Ryan (R) and Senator John Sununu (R)
 - Divert 6.4% of wages to private accounts.
 - 10% on the first \$10,000 and 5% on wages above \$10,000
 - Accept lower benefits.
 - A guarantee that “... workers would get at least as much from combined government benefits and personal accounts as Social Security promises today.”
 - This will be paid by cutting other government spending growth and increased tax revenue from increased saving and corporate investment.

Some Alternative Proposals (5)

- Bill Clinton (former President)
 - Invest Social Security fund in the markets as opposed to lending it to the government.
 - Investments will be supervised by independent boards.
 - Problem: Undesirable interference by government in business.

Is Social Security Program in Crisis?

- It will be in crisis in about a decade if nothing is done.
- However, Medicare is in crisis right now.
- Alan Greenspan, testifying before the House budget committee, said, “So long as healthcare costs continue to grow faster than the economy as a whole, the additional resources needed for such [programmes] will exert pressure on the federal budget that seems increasingly likely to make current fiscal policy unsustainable.”