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LOS ANGELES, CA

90095-1656

(310) 794-5908

SOCIAL SECURITY REFORM: IMPLICATIONS FOR LATINO RETIREES

PATRICIA A. HALLIWELL, ZACHARY D. GASSOUMIS, AND KATHLEEN H. WILBER

ETHEL PERCY ANDRUS GERONTOLOGY CENTER

UNIVERSITY OF SOUTHERN CALIFORNIA

The impending retirement of the baby boom generation has increased debate on the long-term viability of Social Security and prompted a number of suggestions for reform. As a group, Latinos are particularly reliant on the Social Security safety net and thus are especially vulnerable to any changes made to the program.

A high proportion of Latino elders live in poverty and are dependent on Social Security for their basic needs. The Social Security Administration (SSA) has indicated that 39% of elderly Latino married couples and 58% of elderly Latino unmarried persons receive at least 90% of their income from Social Security (Social Security Administration 2004). At the same time, the overall Latino population is relatively young. Recent Census data suggest that 90% of the Latino population is less than 55 years of age, compared with 76% of non-Latinos (U.S. Census Bureau 2005). Younger Latinos can expect to be called on to help finance Social Security's "legacy debt"—the debt that began to accumulate when the benefits paid to early beneficiaries far exceeded the value of their contributions.

In addition to describing and analyzing the reform options, this report examines the impact that different proposals will have on Latino retirees as a whole.

PROPOSED REFORM OPTIONS

Although the Social Security Trust Funds currently have a surplus, this reserve is expected to be depleted by 2040.[1] A number of reforms have been proposed that would strengthen the long-term outlook for Social Security. Table 1 groups the proposals into three categories: 1) those that increase the amount contributed by workers; 2) those that reduce the amount paid to beneficiaries; and 3) other, alternative strategies.

Increasing Worker Contributions. Employees and employers each contribute a percentage (6.2%) of the worker's pay to Social Security through a payroll tax. In 2007, the maximum amount that can be taxed is $97,500. One reform option would increase the maximum amount by making 90% of national earnings subject to the tax, reversing a recent decline to only 85% of national earnings subject to taxation (Diamond and Orszag 2004). A related option would raise the amount of earnings subject to the tax to $120,000 and subject earnings over $120,000 to a 3% surtax. This surtax would help cover the legacy debt (Aaron and Orszag 2004). A third approach would require that all newly hired state and local government workers participate in Social Security. Because state and local workers are currently not required to participate, about 25% do not pay into the program (Altman 2005).

TABLE 1. SELECTED PROPOSALS TO REFORM SOCIAL SECURITY

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

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

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

[2] Does not address solvency, would increase government debt.

Reducing Beneficiary Payments. Certain proposals suggest changing the formula used to calculate beneficiaries' cost-of-living adjustments (COLA), which are the annual increases in monthly Social Security benefits that account for inflation (Social Security Administration 2005). Some experts contend that current calculations overstate increases in the actual cost of living and should rely on a more accurate measure (Altman 2005). Alternatively, some recommendations call for a reduction to the COLA by a fixed percentage (Chaplain and Wade 2005). Another approach proposes changing the benefit computation period from 35 to 38 years. Currently, the SSA averages the 35 years in which a worker's inflation-adjusted earnings were the highest. Other proposals include increasing the age of eligibility for full Social Security benefits and changing the way in which Social Security is taxed, so that those benefits that exceed worker contributions would be taxed like other income, similar to the current taxation of private pensions.

Other Strategies for Reform. Several approaches suggest more substantive changes to Social Security. One such reform proposes converting the estate tax into a dedicated Social Security tax (Altman 2005). Another option would reduce benefits for individuals over a certain income level. Several proposals would introduce public and private investment strategies. One public investment strategy calls for the investment of 15% of Social Security Trust Fund assets in equities (AARP 2005). More controversial is a private investment strategy that would divert a portion of each worker's Social Security contributions to individual retirement accounts, shifting the responsibility for retirement income from the federal government to the individual retiree.

EFFECTS ON LATINO RETIREES

Table 1 also notes whether each reform option will have a beneficial or potentially detrimental effect on Latino retirees.

Beneficial Impacts. The approaches that are most likely to have a positive impact on Latino retirees are those that increase the amount paid into Social Security by high-wage workers, those that increase the number of workers contributing to Social Security, and those that actively increase the Social Security Trust Funds without increasing worker contributions.

Of these approaches, increasing the maximum amount of earnings subject to the payroll tax and converting the estate tax into a dedicated Social Security tax would preserve Social Security's progressive nature without negatively affecting low-wage workers. Since the Latino middle and upper classes are relatively small compared to the middle and upper classes of non-Latino whites, these options would affect a relatively small percentage of Latino beneficiaries (Kochhar 2004).

Detrimental Impacts. The options that would have the most negative effect on Latinos are modifying the annual COLA, increasing the full retirement age, and extending the benefit computation period.

Any reduction in the COLA or its calculation could negatively impact Latino retirees. The COLA maintains retirees' purchasing power no matter how long they live, an especially important factor for Latinos, who have a longer average life expectancy than the population as a whole (Hendley and Bilimoria 1999).

U.S. Census Bureau occupation data reveal that more than half of Latino men work in jobs that are likely to be physically demanding, making it less desirable for them to continue working past the minimum age of retirement (Ramirez 2004). Increasing the retirement age not only would mean more years required in the work force but also could result in a greater reduction in benefits when those workers retire early, at age 62.

Increasing the benefit computation period from 35 to 38 years would reduce Social Security benefits most for groups with short or intermittent work histories, including Latino elders (Walker 2005). This reform would especially affect immigrants who have not lived in the United States long enough to complete even 35 years of work (Hendley and Bilimoria 1999).

In addition, taxing Social Security benefits that exceed contributions would impose additional financial burdens on Latinos. While this strategy would increase revenue to the Social Security system, this revenue would disproportionately come from the benefits received by retirees who have low earnings, all other factors being equal.

Finally, privatizing a portion of Social Security would be problematic for many Latinos. Privatization proposals have not offered a satisfactory mechanism to redistribute funds to low-wage earners, leaving disadvantaged Latino retirees at risk of economic crisis. Also, the high cost of making the transition to private retirement accounts casts doubt over the benefit of such a reform.

RECOMMENDATIONS

- The comparatively large role that Latinos will play in financing the Social Security system in years to come must be considered when weighing options for reform.
- Any proposal for reform must ensure that its impact will not fall disproportionately on those who are least able to bear the burden.
- In addition to reform options, introducing and strengthening other programs would help sustain Social Security. These programs include the promotion of private saving and investing through tax incentives and the creation of government-subsidized personal retirement accounts.
- Although balancing the Social Security system is crucial to its successful performance in the future, reforms that change its function and purpose would not necessarily be positive for its long-term viability.
- When analyzing the various options for reform, policymakers must consider the social contract that the Social Security system has with American workers, which has made it one of this country's most cherished social programs.

NOTES

This brief is excerpted from Latinos and Social Security Research Report no. 2, available at www.chicano.ucla .edu/press/briefs/LSSPB.asp.

1. Assumptions about the long-term future of Social Security are uncertain, resulting in differing projections across time and between actuaries. For example, in 1997, the Social Security Board of Trustees estimated that the trust funds would be exhausted in 2029 (Social Security Administration 1997).

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AUTHORS

Patricia A. Halliwell is a graduate student in gerontology and occupational therapy at the University of Southern California.

Zachary D. Gassoumis is a graduate student at the University of Southern California Davis School of Gerontology.

Kathleen H. Wilber is the Mary Pickford Foundation Professor of Gerontology at the University of Southern California Davis School of Gerontology, and a professor of health services administration in the USC School of Policy, Planning, and Development.

FOR MORE INFORMATION, CONTACT:

Center for Policy Research on Aging

E-Mail: torres@spa.ucla.edu or sw12001@ucla.edu

Websites: www.usc.edu/dept/gero/ • www.chicano.ucla.edu/
www.spa.ucla.edu/main2.cfm?d=xr&f=cpra.cfm&s=Research

Project Director: Bum Jung Kim
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CENTER FOR POLICY RESEARCH ON AGING
UCLA SCHOOL OF PUBLIC AFFAIRS
3250 PUBLIC POLICY BUILDING
BOX 951656
LOS ANGELES, CA 90095-1656

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