“Private” Social Security? **July 2000**

Q. When politicians talk about making Social Security “private,” what do they mean?

A. When people talk about “privatizing” Social Security, they are referring to the proposal to allow workers to contribute funds into their own individual retirement accounts, rather than into the Social Security Trust Fund.

Under current law, employees pay a Social Security tax on part or all of their wages, and this is matched by their employer. Self-employed people pay both shares. This money is deposited in the Trust Fund and used to pay benefits to today’s retirees. This is a “pay as you go” system. Under a “private” approach, workers would be allowed to divert some or all of their contributions into investments of their own choosing.

However, allowing younger workers to create new savings accounts and still providing enough money to support today’s retirees could place a much greater tax burden on today’s workers. In addition, younger workers would bear the full risk of any bad investments they made, whereas under Social Security, the funds of millions of workers are pooled together, spreading the risk. Social Security provides a guaranteed level of support, with an automatic inflation adjustment. Private accounts come with no such guarantees, and depend on how much you can save and your investment decisions.

Under Social Security, workers also have protection if they become disabled, or die. In a private system, if you die or become disabled, your savings may not have had a chance to grow.

Q. Do people really get their money’s worth from Social Security?

A. Social Security should not be compared to a mutual fund or an IRA. It is also an insurance policy. For example, if a 27 year old worker with average earnings, a wife and two children, wanted to buy a disability insurance plan and a life insurance policy that equaled Social Security protection, he would have to buy a disability plan worth at least $207,000, and a life insurance plan worth $307,000. Six out of ten people on Social Security are retired workers, but the remainder are disabled, or dependents or survivors of deceased workers, including more than three million children. In all, Social Security provides Americans with more than $12 trillion in life insurance protection - which is more than the total value of all private life insurance policies in the United States. Employees entering the workforce today can expect the value of their future Social Security to be approximately equal to their contribution and their employer’s. It’s true that investing in private accounts might provide higher returns, but the risk of losing money is higher also.

Finally, critics of “private” social security point out that higher taxes would be needed to set up a system of private accounts while protecting current retirees, leaving today’s workers with negative returns from their accounts. And, without Social Security, half of the elderly today would be living in poverty. ####