

NATIONAL CENTER FOR POLICY ANALYSIS

The Effect Of The Social Security System On Black Americans

Like many economic policies of government, Social Security allocates a tax burden and redistributes income among the American people. For some citizens, participation in Social Security will be a net burden. For others, it has been a bonanza.

Take, for example, the famous case of Ida Fuller of Brattleboro, Vermont. History has recorded Mrs. Fuller as the first recipient of Social Security benefits. She died in 1975 shortly after her 100th birthday, and without a doubt she got a terrific deal from the Social Security program. Before her retirement in 1940 Mrs. Fuller had paid about \$23 in Social Security taxes. She received more than \$21,000 back in Social Security benefits.

Several studies have shown ¹ that the older you are, the better you fare under Social Security. Today's Social Security retirees are receiving benefits which are 4 to 5 times the amount they contributed in taxes. At the same time the system is becoming increasingly less advantageous for young people. In fact, for the youngest of today's workers, Social Security taxes will exceed expected Social Security benefits.

As a recent New York Federal Reserve Bank study put it, "If for a period of time people receive benefits that are on average worth more than the value of their contributions, at some point others will on average have to receive less than the value of their contributions."

While most people recognize that Social Security favors the old over the young, few realize that the system also favors some individuals over others within the same age group.

1. See Martin Feldstein and Anthony Pellechio "Social Security Wealth: The Impact of Alternative Inflation Adjustments," in Colin Campbell, ed., Financing Social Security (Washington, D.C.: American Enterprise Institute, 1979), pp. 91-117, and Anthony Pellechio and Gordon Goodfellow, "Individual Gains and Losses from Social Security Before and After the 1983 Social Security Amendments." Paper presented to the CATO Institute Conference on Social Security, June 6-7, 1983, Washington, D.C.

Using data collected by the National Center for Health Statistics, the NCPA compared the life expectancies of white and black Americans (men and women) with the retirement age under the newly legislated Social Security reforms. What emerged was a dramatic gap between the benefits which white men and women can expect to receive upon retirement and those which their black counterparts can expect. We found that the black population can expect to receive considerably fewer benefits from Social Security.

There are two major reasons why blacks benefit less than whites. First, blacks have a lower life expectancy than whites and therefore fewer years to draw retirement benefits. Second, the black population as a whole is much younger than the white population.

SOCIAL SECURITY BENEFITS AND LIFE EXPECTANCY: MALES

- A black male born today has a life expectancy of 64 years. As such he can expect to die three years before he reaches the Social Security retirement age, which at that time will be 67.
- By contrast, a white male born today has a life expectancy of 70.6 years. He can expect to receive three years plus 7 months of benefits before he dies.

Both individuals can expect to pay more than \$60,000 in Social Security payroll taxes during their working lives. Yet, only the white male can expect to receive Social Security benefits.

Because expected Social Security Benefits are based on life expectancy, it is important to understand how life expectancy tables work. Life expectancy represents the number of years that people will live on the average. Some individuals will die before they reach that age. Others will live beyond that age. The "expected number of years of life," therefore represents an average life span. As people grow older, the fact that they have survived to their current age increases the age to which they can expect to live. As a result, the age to which an individual can expect to live rises as the person's age rises.

For example, although a black male at birth today is expected to live to age 64, a black male at age 25 today can expect to live to 67. A black male age 35 today can expect to live almost to 69. And a black male age 70 today can expect to live to 81.

At every age level, however, blacks have a shorter life expectancy than whites. Therefore, at every age they can expect to receive fewer Social Security benefits compared to their white counterparts. As Table I shows:

- A black male age 25 today can expect to receive about five months of Social Security benefits. A white male at the same age can expect more than six years of benefits.
- A black male age 35 today can expect to receive 2 years, 8 months of benefits, while a white male at the same age can expect 7 years, 6 months of benefits.

SOCIAL SECURITY BENEFITS AND LIFE EXPECTANCY: FEMALES

Among women, the difference between the life span of blacks and whites is similar to men, or about six years. A white woman born today has a life expectancy of 78.2 years; a black woman, 72.7 years.

As a result, white women at birth can expect 11.2 years of retirement, while black women at birth can expect only 5.7 years of retirement. When translated into expected benefits, the discrepancy is substantial. As Table II shows:

- A white female born today can expect almost twice as many monthly benefit checks as a black female.
- A white female at age 20 today can expect 60 percent more benefit checks.
- A white female at age 35 can expect 44 percent more benefit checks.

Compounding the inequity caused by a shorter life span is the fact that black women traditionally have had a higher participation rate in the labor force. This tends to put the black population at a disadvantage in another way.

As the system currently is structured, a retired worker receives about 50 percent more benefits for a dependent spouse. The spouse is entitled to these benefits even though she never worked or paid Social Security taxes. A woman who works all her life can draw full benefits on her own record, but she cannot draw both benefits—those she earned in her own right plus those as a spouse. As a practical matter, this rule tends to penalize women who work, because they end up paying taxes in order to receive roughly the same amount of benefits they would have received had they never worked.

Of course, this feature applies equally to blacks and whites. Historically, however, black women have tended to work more than white women. In 1960 their participation rate in the labor force was 32 percent higher than whites.² This means that white couples who are retired today probably are getting a significantly better deal from Social Security than are black couples, all other things being equal.

THE AGE DISTRIBUTION OF BLACKS AND WHITES

Thus far, we have shown how blacks are disadvantaged as individuals. In addition, they are also disadvantaged collectively. This is because blacks are over-represented among taxpayers and under-represented among beneficiaries.³

- Twelve percent of the U.S. population under 65 is black, but only eight percent of the population over 65 is black.
- The percentage of those of taxpaying age who are black is 50 percent higher than the percentage of those retirement age who are black.

In addition, among the population over 65 years of age, it appears that a smaller percentage of blacks than whites qualify for Social Security benefits.⁴

- Among families with a head of household over 65, 93 percent of whites, but only 89 percent of blacks, receive Social Security benefits.
- Among unrelated individuals over 65 (about 30 percent of the elderly), 92 percent of whites, but only 82 percent of blacks, receive Social Security benefits.

Exact statistics are not available, but it is probably true that considerably more is being taken from the black population in Social Security taxes than is being paid back to that population in the form of benefits. To a large extent Social Security appears to be transferring income out of the pockets of black workers and into the pockets of white retirees.

2. Civilian Labor Force and Participation Rates by Race, Sex and Age: 1960 to 1980; Statistical Abstract of the United States, 1981; page 381.
3. Families and Unrelated Individuals by Type of Income and Poverty Status: 1979; Statistical Abstract of the United States, 1981; page 451.
4. Resident Population, by Age, Sex and Race: 1970 to 1980; Statistical Abstract of the United States, 1981; page 26.

EXPECTED SOCIAL SECURITY BENEFITS AND THE AVERAGE AGE OF BLACKS AND WHITES

There is yet another barrier to equity between blacks and whites. As we have noted, young people do worse under Social Security than old people. The younger you are the worse you fare. This is important to keep in mind when comparing the two races.

On the average, blacks are about six years younger than whites. Factoring in this age difference enlarges the discrepancy in expected benefits between the two races.

- The average white male (age 30) will draw monthly benefit checks for 7.2 years. The average black male (age 24) can expect no monthly benefit checks.
- The average white female (age 33) will draw one and one-half times more benefit checks than the average black female (age 27).

SOCIAL SECURITY TAXES VS. INCOME TAXES

Unlike Social Security Taxes, the income tax system is structured so that workers with lower incomes face lower tax rates. People with very low incomes actually pay a negative tax, i.e., they get a subsidy.

By contrast, Social Security is a flat tax rate. Regardless of income, all workers face a 13.4 percent payroll tax--6.7 percent is the employer's share and 6.7 percent is the employee's share. On the surface it would appear that the employee is liable for only half of the Social Security tax. In reality, however, most economists believe the employee bears the full burden.⁵ In the absence of the 13.4 percent Social Security tax, the employee would have 13.4 percent more in take-home pay.

From the employer's viewpoint, payments made to Social Security are a labor cost, fully comparable to money paid into an employee pension plan, a health insurance plan or wages. For this reason, we have treated the entire payroll tax as a tax which is paid by the employee, in the sense that it represents a sum of money that the employee would otherwise have received in wages and other benefits.

5. See, for example, John Brittain, The Payroll Tax for Social Security (Washington, D.C.: Brookings Institution, 1972).

Social Security taxes are much harder on low-income families. Families with income under \$10,000 a year, for example, pay on the average less than three percent of their income to the federal government in the form of income taxes. By comparison, they pay 13.4 percent of their earnings in Social Security taxes.

Because black families on the average have lower incomes, the Social Security tax burden is proportionately harder on them compared to white families. As Table III shows.

- Over 70 percent of all black families pay more in Social Security taxes (employer and employee shares combined) than they pay in income taxes.

THE EFFECT OF THE RECENT REFORMS

Under the new legislation recently passed by Congress, the retirement age will be raised from 65 to 66 during the years 2003 to 2009 and from 66 to 67 during the years 2021 to 2027. As a result of this change, all younger workers have been made worse off.

Consider the effect of these reforms on 25 year-old male workers. Prior to the reforms, a 25 year-old black male could expect to receive about two years worth of Social Security benefits. But as a result of the increase in the retirement age, he now can expect to receive only about five months of benefits. By contrast, for a 25 year-old white male the period of expected benefits fell from nearly eight years to six years.

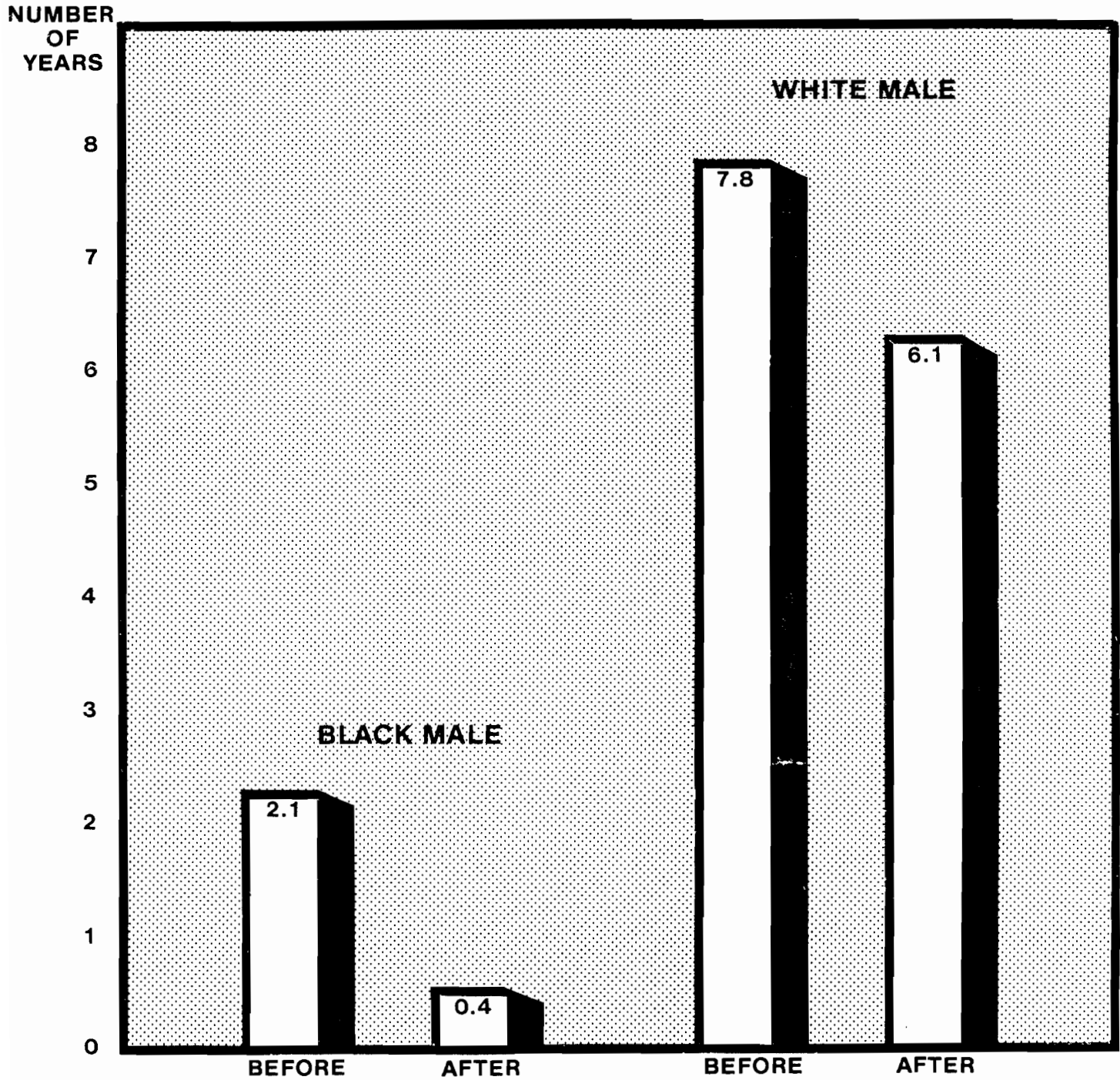
The raising of the retirement age penalized all young workers by reducing their expected Social Security benefits. But the effect on black workers relative to white workers was devastating.

As a result of the increase in retirement age:

- A black male, age 25, lost more than 80 percent of his expected benefits. A white male, age 25, lost less than 22 percent of his.
- Prior to the reforms, the 25 year-old white male could expect about four times more monthly benefit checks as his black cohort. Now, he can expect about 15 times more than his black cohort.

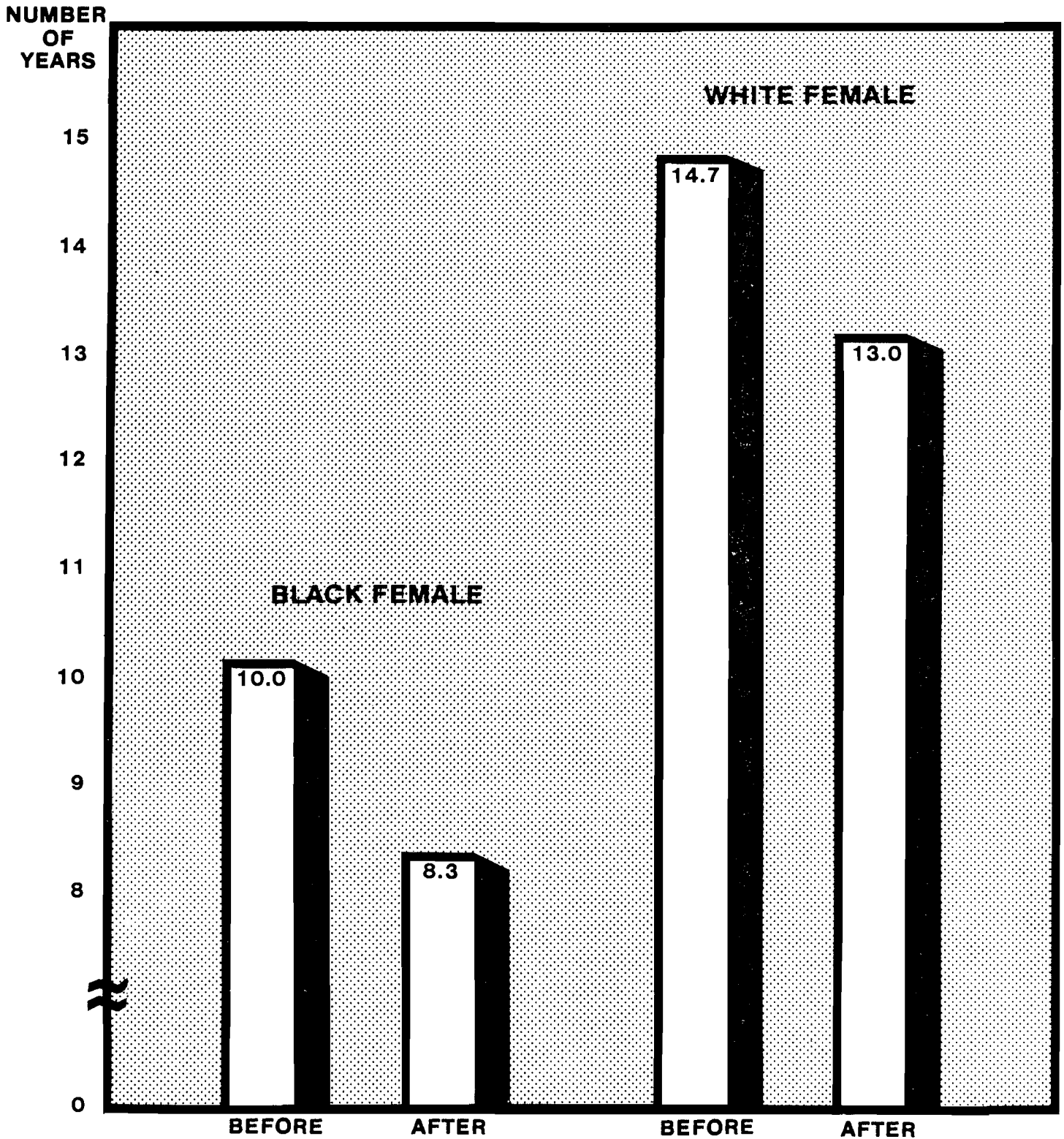
The recently legislated change in the retirement age, endorsed by Republicans and Democrats alike, appears to result in a massive transfer of wealth from blacks to whites.

**EXPECTED NUMBER OF YEARS OF SOCIAL SECURITY BENEFITS
FOR A 25 YEAR-OLD MALE BEFORE AND AFTER THE RECENT
SOCIAL SECURITY REFORMS**



SOURCE: NATIONAL CENTER FOR POLICY ANALYSIS

**EXPECTED NUMBER OF YEARS OF SOCIAL SECURITY BENEFITS
FOR A 25 YEAR-OLD FEMALE BEFORE AND AFTER THE RECENT
SOCIAL SECURITY REFORMS**



SOURCE: NATIONAL CENTER FOR POLICY ANALYSIS

THE EARLY RETIREMENT OPTION

One mitigating factor is that the reforms left intact the option of early retirement, which currently stands at 62 years of age with 80 percent of benefits. Blacks who take early retirement will still be entitled to the same partial benefits, as they were prior to the reforms.

However, based on life expectancy at birth, a black male who chooses the early retirement option will receive only two years of partial benefits. By contrast, his white counterpart making the same choice will receive 8.6 years of partial benefits, over four times as many benefit checks as the black worker.

In addition, it is important to note that the same pressures that were exerted to raise the full retirement age from 65 to 67 probably will be applied again, at a later date, to raise the early retirement age too. With their shorter life span, blacks will be hurt more than whites if this change occurs.

MEDICARE AND BLACKS

The bias of Social Security against blacks carries over into Medicare. About two percentage points of the 13.4 percent payroll tax is paid to finance the Medicare program. Under current law, citizens must reach the age of 65 before they are entitled to Medicare benefits.

Here again, blacks are at a disadvantage. A black male at birth is expected to die one year before he reaches the age of Medicare eligibility, even though he still must pay Social Security taxes that help fund Medicare. By contrast, a white male can expect full Medicare benefits near the time of his death.

The recent Social Security reform legislation left the Medicare eligibility age of 65 intact. However, considerable pressure is building to raise the eligibility age in line with the increase in the retirement age in order to solve projected Medicare deficits.⁶ According to current projections, the Medicare trust fund is expected to run out of money before the end of this decade, while the deficit through 1995 is projected to be between \$200 and \$400 billion.

Should the eligibility age be increased, it will not reduce the amount of Social Security taxes that black workers can expect to pay. It will dramatically reduce their expected benefits under Medicare, however, both in absolute terms and relative to their white cohorts.

6. See Spencer Rick, "200 billion Medicare Deficit Seen," Washington Post, June 4, 1983.

ALTERNATIVES TO THE STATUS QUO

Aside from the question of equity, the Social Security reforms will have little effect on the problem of long-term solvency.⁷ In the short run, the new legislation will solve the crisis in funding. But economists and actuaries alike are in agreement that the legislation does not solve the long-term financing problem and that the crisis will reappear sometime in the future.

There are governments in the world today, Great Britain and Chile, for example, which have taken major steps to reduce the long-term problem of funding their pension systems.⁸ Interestingly enough, the reforms which they adopted not only reduce the funding problem but also reduce any built-in inequities between races.

How did they do it? By instituting either partial or complete voluntary participation in Social Security. Britain, for example, has a two-tier system, with participation in the first-tier mandatory, but participation in the second-tier voluntary. Companies are encouraged to opt out of the second tier and set up private pension plans for their employees.

Chile has a government-run pension plan that is entirely voluntary. The system is designed so that it is to a worker's advantage to opt out of the government plan and set up the Chilean equivalent of an IRA.

In both instances the long-term problem of solvency has been reduced because the number of participants (and therefore the number of retirees drawing benefits) has been reduced. Similarly, any discrepancy in the return-of-benefits ratio between various races has been reduced by virtue of more citizens having direct control over their own individual pensions.

Oddly enough, the National Commission on Social Security Reform did not hear testimony from a single individual describing how opting out works in other countries. In future discussions regarding the fate of Social Security, the American people should be told about the successful examples set by Great Britain and Chile.

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7. The long-term problem of Social Security has been described in: Peter Ferrara, Social Security: The Inherent Contradiction (San Francisco: CATO Institute, 1980), and A. Haeworth Robertson, The Coming Revolution in Social Security (McLean, Virginia, Security Press, 1981).
8. For a description of the British social security system, see John Goodman, Social Security in the United Kingdom: Contracting Out of the System (Washington, D.C.: American Enterprise Institute, 1981). For a brief description of the social security systems of Britain and Chile, see John Goodman, "Lessons from Abroad," The Heritage Lectures; Rebuilding Social Security, volume 18, 1982. pp. 23-31.

TABLE I

Expected Number of Years of
Social Security Benefits

Male

<u>Current Age</u>	<u>White</u>	<u>Black</u>
At Birth	3.6	0
1	4.5	0
2	4.6	0
3	4.6	0
4	4.6	0
5	4.7	0
6	4.7	0
7	4.7	0
8	4.8	0
9	4.8	0
10	4.8	0
11	4.8	0
12	4.8	0
13	4.8	0
14	4.9	0
15	4.9	0
16	5.0	0
17	5.0	0
18	5.1	0
19	5.2	0
20	5.3	0
21	5.4	0
22	5.5	0
23	5.6	0
24	5.9	0
25	6.1	0.4
26	6.4	0.7
27	6.7	1.1
28	6.9	1.3
29	7.1	1.7
30	7.2	1.9
31	7.3	2.0
32	7.3	2.2
33	7.4	2.3
34	7.5	2.5
35	7.5	2.7
36	7.6	2.9
37	7.7	3.0
38	7.8	3.2
39	7.8	3.4
40	7.9	3.6

Table assumes worker does not retire until he reaches the social security retirement age. Length of benefit payments is based on life expectancy and recently legislated changes in the retirement age.

Source: Life expectancy rates taken from U.S. National Center for Health Statistics.

TABLE II

**Expected Number of Years of
Social Security Benefits:**

	<u>Female</u>	
<u>Current Age</u>	<u>White</u>	<u>Black</u>
At Birth	11.2	5.7
1	12.0	7.1
2	12.1	7.2
3	12.1	7.3
4	12.2	7.4
5	12.2	7.4
6	12.2	7.4
7	12.2	7.5
8	12.2	7.5
9	12.3	7.5
10	12.3	7.5
11	12.3	7.5
12	12.3	7.6
13	12.3	7.6
14	12.3	7.6
15	12.3	7.6
16	12.4	7.6
17	12.4	7.7
18	12.4	7.7
19	12.5	7.7
20	12.5	7.8
21	12.5	7.8
22	12.6	7.9
23	12.6	7.9
24	12.8	8.2
25	13.0	8.3
26	13.2	8.6
27	13.4	9.0
28	13.8	9.2
29	13.8	9.3
30	13.8	9.3
31	13.9	9.4
32	13.9	9.5
33	13.9	9.5
34	14.0	9.6
35	14.0	9.7
36	14.1	9.8
37	14.1	9.9
38	14.1	10.0
39	14.2	10.1
40	14.2	10.2

Table assumes worker does not retire until she reaches the social security retirement age. Length of benefit payments is based on life expectancy and recently legislated changes in the retirement age.

Source: Life expectancy rate taken from U.S. National Center for Health Statistics.

TABLE III

Tax Rates For Black and White Families: 1979

WHITE

INCOME LEVEL (\$)	EFFECTIVE INCOME TAX RATE	SOCIAL SECURITY TAX RATE*	PERCENT OF FAMILIES
Less than 5,000	0	12.26	5.40
5,000 - 9,999	1.57	12.26	12.30
10,000 - 14,999	6.04	12.26	15.40
15,000 - 19,999	10.30	12.26	15.30
20,000 - 24,999	13.06	12.26	14.90
25,000 - 34,999	16.57	12.26	20.10
35,000 - 49,000	21.69	12.26	10.90
50,000 and above	30.11	12.26	5.70

BLACK

INCOME LEVEL (\$)	EFFECTIVE INCOME TAX RATE	SOCIAL SECURITY TAX RATE*	PERCENT OF FAMILIES
Less than 5,000	0	12.26	17.90
5,000 - 9,999	2.49	12.26	22.50
10,000 - 14,999	7.48	12.26	17.50
15,000 - 19,999	11.03	12.26	12.30
20,000 - 24,999	13.71	12.26	10.20
25,000 - 34,999	15.10	12.26	12.50
35,000 - 49,999	20.10	12.26	5.40
50,000 and above	28.43	12.26	1.80

*The Social Security tax rate is the combined employer and employee contributions. The tax applies only to the first \$22,900 of income for each family member in 1979.

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